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Politics this week

Mar 2nd 2006
From The Economist print edition

AP

In the wake of last week's bombing of the **Iraqi** Shias' Askariya shrine, a wave of sectarian reprisals ensued, mainly against Sunni Arabs, raising fears that the country might tip into wholesale civil war. Despite a four-day curfew and the deployment of American and Iraqi troops, the communal strife continued, leaving at least 500 civilians dead; some morgue officials put the toll at more than 1,300. See article

The **Palestinians'** caretaker government welcomed the European Union's offer of *euro*120m ($140m) in emergency aid to keep it going. The money will be channelled to aid projects and to pay energy bills. The EU and America are still discussing whether to stop payments after Hamas forms a government.

Iran and **Russia** failed to agree on a Russian proposal to enrich uranium for Iran on Russian soil; the Iranians refused to agree to stop all uranium enrichment at home. Iran requested last-minute talks with Britain, France and Germany, ahead of a board meeting next week of the IAEA, the UN's nuclear guardian.

Authorities in **Saudi Arabia** foiled an attack on the country's largest oil refinery, at Abqaiq, killing four al-Qaeda terrorists. Later, a police raid killed the man the Saudis said was al-Qaeda's leader in the kingdom. **Jordan** said it had thwarted an al-Qaeda plan to attack "a vital civilian facility" in Amman.

For the first time in three years, **Côte d'Ivoire's** president, Laurent Gbagbo, and Guillaume Soro, leader of the main northern rebel group, held talks on Ivorian soil, raising hopes that the divided country may not again descend into outright civil war.

Uganda's incumbent president, Yoweri Museveni, was re-elected by a wide margin over his nearest rival. Kizza Besigye promised to challenge the result, alleging that many of his supporters were prevented from casting their vote. See article

Masked gunmen, believed to be police, made a night raid on the independent-minded Kenya Television Network. Other gunmen burned copies at the printing press of the *Standard* newspaper, part of the same group, which has been investigating shenanigans surrounding **Kenya's** president, Mwai Kibaki.

Hunters and gatherers

A Council of Europe report on alleged illegal detentions and renditions of terrorist suspects at secret airports or on flights operated by the **Central Intelligence Agency** found no evidence that the Americans had broken any laws. But it added that Europe was a "happy hunting ground" where foreign spies could operate with no domestic supervision.

Russia's president, Vladimir Putin, visited Hungary and the Czech Republic. He took a soft tone with his hosts, seeming partly to apologise for actions by the Soviet Union, but also to make up for recent squabbles over energy supplies. See article

The prime minister of **Kosovo**, Bajram Kosumi, resigned after less than a year in office. He had been widely criticised as ineffective. Talks about the ultimate status of the Serbian province continue in Vienna.

Ken Livingstone, **London's** Labour mayor, had his suspension from office stayed by the High Court. He was due to begin a four-week enforced holiday on March 1st for comparing a local journalist, who is Jewish, to a guard in a concentration camp. Mr Livingstone refuses to apologise, insisting that he was merely following his usual method for handling the press.

Fresh blood

Portia Simpson Miller is due to become **Jamaica's** first female prime minister after being elected president of the

ruling People's National Party. This made her automatically eligible to succeed P. J. Patterson, the island's leader for the past 14 years, when he steps down, probably next month.

Honduras's new president, Manuel Zelaya, declared a state of emergency in the country's health-care system, which is facing a shortage of medicines. He entered office in January promising to make poverty a top priority.

Uruguay became the first South American country to bring in a ban on smoking in bars, restaurants, offices and other enclosed public places.

A terminal decline?

The Bush administration said it would take another look at the security issues surrounding the sale of operations in six **American ports** to DP World, which is based in Dubai. Congressional leaders said they would wait for the outcome of the 45-day review before taking any action to block the deal. Separately, an opinion poll for CBS showed George Bush's **approval rating** at a new low of 34%. See article

Reuters

Six months after Hurricane Katrina, **New Orleans** held its annual Mardi Gras celebration, which was somewhat muted. Meanwhile, a video emerged that showed federal officials warning Mr Bush of the risk to the city shortly before the disaster. See article

Cardinal Roger Mahony, leader of the **Los Angeles** archdiocese, said Catholic priests would defy any legislation from Congress requiring churches to check the legal status of immigrants to whom they give assistance. Denouncing anti-immigrant sentiment as "hysterical", the cardinal called for a humane reform of immigration policy.

Speaking as a friend

President Bush arrived in **India** at the start of a state visit and announced a deal on the transfer of American nuclear technology to India. America's Congress will want to look at the details. On his way, Mr Bush paid a surprise visit to **Afghanistan**, where he met Hamid Karzai at the presidential palace. See article

AP

Taiwan's president, Chen Shui-bian, announced the termination of a body supposed to be negotiating reunification with the mainland. China's response (it warned of "disaster") was relatively restrained. See article

Gloria Macapagal Arroyo, the **Philippines'** president, ordered a review of the country's security situation after claiming to have uncovered a coup plot to topple her. Mrs Arroyo declared a state of emergency in the country on February 24th, but pledges to give up her emergency powers as soon as possible.

Thailand's prime minister, Thaksin Shinawatra, called a general election, which the opposition said it would boycott, after weeks of demonstrations against him. Protestors set a deadline for him to resign. See article

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Business this week

Mar 2nd 2006
From The Economist print edition

The French government came under intense criticism for its hastily arranged plan to merge **Gaz de France**, a state-owned utility, with **Suez**, a Franco-Belgian power and water company. The government's move (which will privatise GDF) is designed to protect Suez from a potential hostile bid by **Enel**, an Italian electricity firm. France's announcement came soon after Spain took regulatory measures to protect **Endesa** from a hostile bid by Germany's **E.ON**, and prompted the European Union to warn its members that a rise in economic nationalism could threaten the European single market. See article

National Grid, a British energy company, confirmed it would buy **KeySpan**, a gas and electricity distributor in America's north-east. The deal, worth $11.8 billion including debt, is one of the largest acquisitions by a European firm in the United States and will create the country's third-biggest utility. The takeover is subject to regulatory approval.

Arcelor continued to fight **Mittal Steel's** hostile takeover bid by delivering a "strong commitment" to increase returns to shareholders over the next three years. Mittal maintained that its combination with the Luxembourg-based steelmaker would be superior and create better value. Nevertheless, it dampened speculation that it will increase its *euro*18.6 billion ($23 billion) offer in order to win a deal.

After months of negotiation, which saw two of its lower bids rejected, **Nippon Sheet Glass**, based in Japan, said it would buy **Pilkington**, Britain's biggest glassmaker, in a deal valued at around £2.9 billion ($5 billion). The news marks the end of the independent existence of Pilkington, which was founded in 1826. Some analysts wondered if Nippon had bitten off more than it could chew by acquiring a firm twice its size.

The board of South Korea's largest tobacco and ginseng company, **KT&G**, rejected a $10 billion takeover bid from a group of investors led by **Carl Icahn**. Mr Icahn's offer, which may yet be put to tender, is viewed as a test case against which future bids for large domestic firms will be measured; the Korean government has said it will look at toughening takeover regulations. See article

Getting patently absurd

NTP and **Research in Motion** continued the war of words in their patent dispute, which threatens to shut **BlackBerry** services in the United States. Both companies issued ill-tempered statements accusing each other of misconstruing arguments in the case, in which RIM, maker of wireless e-mail devices, has been found to have infringed NTP's patents. On February 24th the judge admonished both sides for failing to reach a settlement, but delayed a decision to shut BlackBerry down.

Comments made by **Google's** chief financial officer on the limits to the firm's growth caused jittery investors to wipe 7% off its share price on February 28th. George Reyes said that Google's fortunes would now also depend on other services, as growth was slowing in its paid-search advertising, which now accounts for virtually all its sales.

Vodafone, the world's largest mobile operator, announced that it would write down the value of its assets by up to £28 billion ($49 billion), most of it goodwill stemming from the company's £101 billion takeover of Mannesmann in 2000. Vodafone also lowered its sales and profit forecasts, putting more pressure on Arun Sarin, its chief executive.

Fly boys

Northwest Airlines continued negotiations with its pilots over pay and working practices. Earlier, the pilots authorised their union to call for strike action if the company attempted to impose "onerous working conditions" as part of a turnaround plan to leave bankruptcy protection. Meanwhile, the carrier reported that it had made a loss of $2.6 billion last year.

Bowing to pressure from senior managers in the company, **Japan Airlines** announced that Toshiyuki Shinmachi is to step down as chief executive in June. The carrier has been plagued by a series of safety scares lately that has seen passengers flock to its main rival and contributed towards poor quarterly results.

Sony will sell a controlling stake in five of its retailing businesses to Nikko Principal Investments. The move is seen as an initial step in the company's divestment strategy, unveiled last year, of its non-core electronics businesses.

A spring in their step

The **euro area's indicator of economic sentiment** (which surveys executives and consumers) reached a five-year high, driven by a positive outlook in the industrial sector. Some analysts think the measure, coupled with a sharp drop in January's core inflation rate, confirms that economic recovery is well under way in the region. See article

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Iraq

At war with itself

Mar 2nd 2006
From The Economist print edition

It is a time of misery, of tragedy, of brutality

Get article background

SOMETIMES after people peer into an abyss, they have the sense to step back. For the moment, however, Iraqis are continuing their march of folly. The bombing last week of the Shias' revered Askariya mosque in the city of Samarra unleashed the most intense sectarian violence since the American invasion and the toppling of Saddam Hussein nearly three years ago. What began as a Sunni-dominated insurgency against the occupiers is now beginning to look increasingly like a civil war between Iraqis themselves. This is no doubt exactly what the mosque's attackers were hoping for. Such a war would plunge Iraq deeper into mayhem and mark the definitive failure of George Bush's vaunted "freedom" project in the Middle East, not just in the eyes of Arabs but in those of Americans, too. In the aftermath of the new violence, one poll showed Mr Bush's approval rating at 34%, the lowest of his presidency.

A schism not just in Iraq, but also in Islam

The prevention of a Sunni-Shia civil war should now be America's foremost priority in Iraq. Such a war might not only suck in Iraq's immediate neighbours, pitting Saudi-backed Sunnis against Iran-backed Shias. It might have effects even further afield, along the Sunni-Shia fault-line that runs through Islam as a whole (see article). At this point, however, it is no longer in the power of the Americans alone to prevent such a catastrophe. It is primarily a job for Iraqis themselves. And it is not so much a military job as a political one. The Shia majority that came out on top in January's general election needs urgently to show that it is willing to share real power with the parties that represent the Sunni minority.

Until now, two menacing factors have worked against this. First, most Sunni Arabs, who have run Iraq since its creation nearly 90 years ago, seem bizarrely loth to admit that they number barely a fifth of the population—and cannot see why they should not continue to run the show. Hence their endorsement of the insurgents, even while electing representatives to parliament. Second, the newly dominant Shia Arabs, with 60% of the people, seem increasingly loth to grant the Sunnis a fair share in government, especially since they seem unable or unwilling to stop insurgents from carrying out sectarian outrages such as bombing the shrine. Many Shias now think they simply can and must bash the Sunnis into submission—and may better be able to do so once the ring-holding Americans and their allies go. Worse still, the Shias are divided among themselves, with three of their parties competing bitterly within the ruling alliance. After the shrine's bombing, many prominent Shias actually blamed America for the deed. With so deep a reluctance to embrace compromise or reason, what possible hope for the future?

Optimistic as it may seem in the circumstances, the events surrounding the bombing of the shrine may hasten the much-needed first big step towards forestalling all-out civil war: the formation of a unity government embracing all the main ethnic and religious factions. Though the new constitution gives the recently renominated prime minister, Ibrahim al-Jaafari, a couple more months to forge a ruling coalition, he should speed things up before sectarian

hatreds overtake the country. It is vital that at least the four—and preferably the five—leading alliances in parliament (the Islamist Shia list to which Dr Jaafari belongs, the Kurds, the main Sunni Islamist group and the non-sectarian secularists led by Iyad Allawi, a Shia who has Sunni partners) team up in a government. It is equally vital that key ministries—defence, interior and finance, among others—be shared out, with Sunnis getting serious ones, and that ministers are prevented from packing them, as before, with cronies. And the Shias should respond to the urgings of America's ambassador, Zalmay Khalilzad, that the present interior minister, a Shia who is said to have allowed sectarian death squads to operate out of his ministry, be sacked.

Once in place, it is no less essential that a unity government amends the new constitution. Much of the constitution is sound, and it was duly approved in a national referendum. All the same, it has become increasingly vital to reassure the Sunnis both that their provinces will get a fair share of future oil revenues and that a Shia "super-region" will not emerge in the south and so break Iraq up. The hardest task of a new government will be to disband militias and reintegrate them into genuinely national forces. So far, most of the Iraqis recruited into the new Iraqi army have been Shia, and their loyalty to the idea of a multi-confessional state is at best uncertain.

For the Shia leadership, making compromises such as these will require a supreme effort of self-control. Having been long oppressed, Iraq's Shias feel that they are gathering strength and are owed their place in the sun. The insurgents have sorely provoked them, striking mercilessly at their homes, markets and holy places. Until recently, influential politicians and clergy, especially the Shias' Grand Ayatollah Ali al-Sistani, had succeeded, as outrage followed atrocity, in restraining the hotheads from wholesale communal revenge. But their words are now being less dutifully heeded.

America in the middle

It would be wrong to say that the insurgents are beating the Americans on the battlefield. But they don't have to. The insurgents win merely by making Iraq ungovernable. The occupying forces and their Iraqi allies have been losing fewer men than before. But they are no longer the main targets. The Americans and their allies must not stay indefinitely: virtually all Iraqis long for them to go. Yet most of Iraq's elected leaders, struggling to build a coalition, agree that an American rush for the exit would, at this stage, still be likelier to provoke a descent into all-out civil war than prevent it.

The greater the sectarian mayhem, the happier the insurgents. Only when the sour Sunni minority is properly represented in a new government is there the faintest chance of persuading enough of the insurgents and their supporters that they have a stake in the new order. Dr Jaafari and his Shia friends have no time to lose. They must compromise, and fast, or risk being left with only the rump of what was once Iraq.

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Thailand

Enemies of democracy

Mar 2nd 2006
From The Economist print edition

Thailand risks taking a step backwards

AP

THIS newspaper has never been a great fan of Thaksin Shinawatra, Thailand's embattled prime minister. His rise to power was fuelled by money, and his money obtained in part by patronage. When, in early 2001, he was on the point of winning his first election, we compared him to Italy's Silvio Berlusconi. It was not intended as a compliment.

In office, Mr Thaksin has been a mixed blessing. He has handled the economy reasonably efficiently, and has therefore managed to afford the extravagant handouts with which he wooed the rural electorate in 2001, and again last year. In other spheres, though, his touch has been much less sure. Sheer governmental incompetence, for example, is the main reason why discontent in Thailand's Muslim south has bubbled over into insurrection and bloodshed.

Mr Thaksin's chief failing, however, is that he has never adequately dealt with the conflicts of interest inherent in his role as prime minister and as Thailand's richest businessman or close to it. Transferring his assets—which include the country's largest telecoms company, an array of media companies and much else—to close family members convinced no one. And when, earlier this year, they decided to sell their main holding company to Singapore's government, the result was not praise but an outcry: the decision came far too late, and the manner in which the deal was struck raised a whole new tangle of questions (see article). The affluent Bangkok demonstrators who have been demanding Mr Thaksin's resignation every weekend for months grew more heated, not less.

On February 24th Mr Thaksin responded by calling a snap election, barely a year after the last one and even though he has an unassailable majority in parliament. This may not be popular, but he has every constitutional right to seek a fresh mandate, and if voters do not like it then a simple and effective remedy will be available to them on polling day. What is more troubling for Thai democracy is the response of the main opposition parties and of the demonstrators in the streets. The former have announced that they will boycott the election, and the latter have said that they are not interested in elections at all. Unless Mr Thaksin resigns by March 5th, declares a group of unelected megaphone-wielders, they will organise mass protests to drive out this enemy of democracy.

Democracy is a young and delicate flower in much of East Asia, and despite the odds it has done pretty well. In the past couple of years, the ballot box has produced a smooth transfer of power in Indonesia, a defeat for the most populist candidate in the Philippines and a parliamentary victory for the opposition in Taiwan—all of them countries which, like Thailand, have had a long history of authoritarian rule. The Philippines has just imposed a state of emergency after yet another of its periodic alleged coup plots, but even there the urge to resort to direct action to overthrow an elected government seems at last to be on the wane.

Although the democratic idea is gradually striking deeper roots in East Asia, these could still be plucked up if people and parties refuse to accept the verdict of the ballot box. The danger in Thailand is that Mr Thaksin's foes will try to achieve through "people power" what they do not have the numbers to achieve at the polls, or that the

army will revert to its previous habit of interfering in politics. In either case, it would not be Mr Thaksin who is democracy's enemy, but those who refuse to accept that he has won an electoral mandate.

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Economic nationalism

From Karl Marx's copybook

Mar 2nd 2006
From The Economist print edition

Efforts to block foreign takeovers rest on a deceit about ownership and interests

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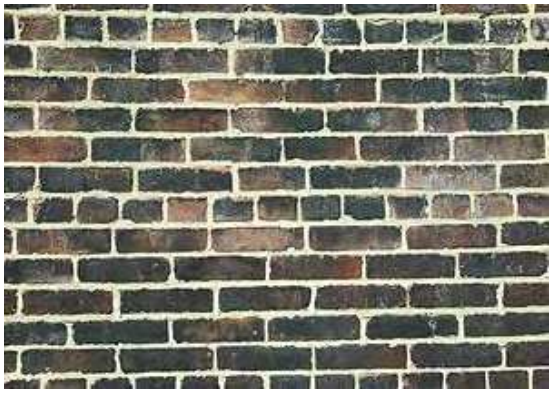

Get article background

PATRIOTISM, said Samuel Johnson, is the last refuge of a scoundrel. That may be unfair to the proper sort of patriot, but it would be an entirely valid comment about politicians today who make a fuss about foreign takeovers in their countries, in the name of "national interests". The truth is that they are not defending their nations' interests at all. They are defending their own interests and (often) those of their cronies.

Such selfish populism has become increasingly popular. Recent weeks have seen American politicians attacking the purchase of a port management firm by DP World from the United Arab Emirates (see article) and proposing new barriers for state-owned buyers to jump; the French prime minister, Dominique de Villepin, hastily arranging a merger between a state-owned gas firm, Gaz de France, and another big utility, Suez, in order to see off an Italian bid for Suez (see article), and proposing other anti-takeover measures; the Spanish government trying to block a German firm's bid for Endesa, a Spanish utility; the Polish government hindering an Italian takeover of a German bank because it involves Polish subsidiaries; South Korean politicians yelling foul at an American-led attempt to buy KT&G, formerly the state-owned tobacco and ginseng monopoly (see article); and the French and Luxembourg governments both trying to discourage a takeover by the world's biggest steel firm, Mittal, for the Franco-Belgian-Luxembourgeois Arcelor.

From the point of view of those who favour open markets for goods, services and capital it is possible to see these political reactions as good news, not bad (see article). They imply, first of all, that there are a lot more cross-border mergers and acquisitions going on than before, notably in Europe, as otherwise there would be nothing to complain about. They may also imply that other refuges of political scoundrels aren't as useful as they once were: trade barriers are hard to erect, especially within the European Union but also more widely thanks to the World Trade Organisation, and the use of public spending to rescue or "create" jobs runs up against state-aid rules, budget-deficit limits and the awkward practical fact that such subsidies don't work for very long. The forces of globalisation, moreover, look much stronger than the measures currently being deployed against them.

Commanding heights

To be entirely sanguine about this spate of economic nationalism could well, however, prove a mistake: it needs to be seen in the wider context of China-bashing in America's Congress, anti-enlargement feeling and even growing racism in some European Union countries, and the continued frailty of the Doha round of trade-liberalisation negotiations. Globalisation is a human construct, after all, not some force of nature; it can be reversed, as has happened in previous bouts of beggar-my-neighbour politics. But even if these anti-takeover movements do prove futile, and don't trigger a broader move to protectionism, that still doesn't make them benign. They introduce distortions and impose costs on the countries that deploy them. And they are, at bottom, corrupt.

The idea that it is somehow in the French national interest that a utility should not become owned by an Italian firm, or in the American interest that ports be kept out of Arab hands, is one to gladden the heart of Karl Marx. His view was that ownership, and hence the power to exploit, was all; hence socialist governments' fateful desire to nationalise the “commanding heights” of their economies. Does Britain suffer because French firms (eg, EDF and Suez) already own large British electricity and water utilities? No: they are subject to exactly the same regulations and labour laws as any other utilities. Would the management of six American ports give DP World control over security there? No: as with any port or airport, it is controlled by the government. The laws of the land and the reach of state or federal agencies are unaffected.

What is affected, however, is the ability of governments and of individual politicians to use patronage at favoured firms to help their friends, to get favours in return, to support special interests such as trade unions, and, in broad political terms, to paint themselves as patriots. Consumers aren't helped, living standards don't rise, the nation as a whole is not better off. But the political and corporate elite may well be.

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Brazil

The magic of Lula

Mar 2nd 2006
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What Brazil's scandal-tarnished president should do with a second chance

AP

Get article background

FOUR years ago, the election of Luiz Inácio Lula da Silva, a former lathe-operator and trade-union leader, as president of the world's fourth-biggest democracy aroused the fears of some investors and the hopes of many poor Brazilians. His Workers' Party had long campaigned for socialism. Once in power, however, "Lula" showed himself to be a pragmatist. He is all but certain to seek a second term in October's presidential election, and polls suggest he may win. In a rare interview this week (see article and highlights from the interview), Lula gives his own account of what he has achieved so far and where he is going. What should outsiders make of his record?

By the standards of other big emerging economies such as China's and India's, Brazil continues to disappoint. Latin America's giant grew by an annual average of 2.6% over the past three years, and is unlikely to grow by more than 4% in 2006, despite falling interest rates and a pre-election spending binge. Public debt and taxes remain too high, public pensions are over-generous and there is too little public investment.

By the standards of its own recent past, however, Brazil is faring well. What looked like an economic miracle under military rule in the 1960s and 1970s came at the cost of inflation and debt. The dictatorship was followed by a wasted decade, while democratic politicians enshrined a prosperity-destroying system of over-regulation and economic nationalism in a new constitution. Nonetheless, over the past decade Brazil has at last begun to lay the foundations of sustained growth.

Lula is building on work begun by his predecessor, Fernando Henrique Cardoso, but has done so with considerable courage. He has stuck to tough-minded monetary and fiscal policies even when these have been unpopular. He has at the same time begun to tackle social inequalities with a massive poverty-relief programme that now reaches 8.7m families.

Whoever forms Brazil's next government should continue on this path. Ideally, the pace of reform should be speeded up. Brazil needs to shrink its public debt and make more space for public investment and lower taxes. Failure to do so will mean unnecessarily high interest rates and leave the country vulnerable to any stumble in the world economy (see article). But there are ways and ways to reform.

Win the argument, don't resort to bribery

Brazil is a hard country to change—especially when no party has a majority in a fragmented Congress. The business of assembling congressional majorities in order to loosen the economic straitjacket of the constitution is painfully slow. Behind each constitutional restriction stands a vested interest of one sort or another. In their quest for a majority, Workers' Party leaders are alleged to have cut corners with Leninist arrogance, paying bribes to

small rent-a-parties.

This scandal has damaged his party more than Lula himself. Many Brazilians appear to feel that whatever went on was no worse than in the past. They trust Lula's good intentions, and seem willing to give him the benefit of the doubt. If he is re-elected, however, Lula needs to clean house—not for Brazil's sake alone but also in the interests of the region.

Brazil's approach—the patient building of institutions and consensus—has much to recommend it in a Latin America where the socialist populism of Venezuela's Hugo Chávez has lately attracted far more attention. In a few years' time, when Venezuelans face the bill for Mr Chávez's decapitalisation of their economy, Brazilians should be reaping the fruits of fiscal responsibility in the form of sustainable growth.

On taking office, Lula offered himself as a bridge between two worlds, between the Davos crowd of business types and the World Social Forum of social and environmental activists. He can still command influence in both of these worlds. In Britain this week he intends to push for compromise in the Doha round of world trade talks. Brazil's quiet diplomacy may yet persuade Bolivia's socialist president, Evo Morales, to follow the path of democracy and pragmatism rather than the example of Mr Chávez. To do all this, however, Brazil must lead by example—reforming its economy and helping its legions of poor people by winning the political argument and playing by the rules, not resorting to bribery and the quick fix.

Lula is not just a charismatic politician but also, it seems, a lucky one. He promised clean government, presided over a corruption scandal, and yet still looks capable of winning a second chance. He has the potential to become one of Latin America's most remarkable democratic politicians. But the greater part of his work still lies ahead of him.

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About sponsorship

Corruption

Wolfowitz's new war

Mar 2nd 2006
From The Economist print edition

To battle graft, the World Bank's president needs a proper strategy

Reuters

WHEN George Bush nominated Paul Wolfowitz to head the World Bank a year ago, plenty of people worked themselves into a tizzy. Would the former deputy defence secretary turn the world's top aid agency into an arm of American foreign policy? Would the intellectual architect of the Iraq war make as much of a hash of fighting poverty as his former employers had made of governing Iraq? So far, there is scant evidence that Mr Wolfowitz bows to America's bidding. On both climate change and debt relief, the Bank's president has taken issue with his former boss. For all that, his impact on the Bank and poverty is unclear. His tenure will depend, in large part, on the outcome of a new campaign: his attack on graft.

With little fanfare, the former Pentagon man has launched an unprecedented offensive against corruption (see article). The Bank has stopped or delayed projects, including loans to India, Bangladesh, Argentina and Kenya, because they whiff of graft. It suspended loans to Chad after the government reneged on an agreement designed to minimise the filching of oil revenues. It stalled assistance to Uzbekistan, a corrupt place with a nasty human rights record. On February 24th Mr Wolfowitz sought to toughen up the debt relief for the Republic of Congo, an oil-rich African country with a notoriously kleptocratic elite. He has also beefed up the Bank's own anti-corruption unit. The approach may be ad hoc, but there is no mistaking the deliberate and consistent theme: corruption is at the top of the agenda and Mr Wolfowitz's Bank will not tolerate it.

That is a message worth sending. Although some poor countries such as Bangladesh and China do grow fast despite corruption, most do not. Governance matters as much for helping the poor as economic policy does. Blatant graft corrodes voters' support in the rich world for debt relief and aid.

To be fair, James Wolfensohn, Mr Wolfowitz's predecessor, condemned the "cancer of corruption" a decade ago. Yet the Bank's lending practices have failed to match its rhetoric. Although the allocation of soft loans is now influenced by countries' scores on governance, fighting corruption is less ingrained among Bank staff than, say, the environment. Which is why Mr Wolfowitz's decision to block projects makes sense.

But it is not enough. To battle corruption successfully, Mr Wolfowitz needs a more coherent strategy than simply saying no to isolated loans. In the absence of clear criteria on corruption, he will be open to the charge of arbitrariness. His Congo scheme, for instance, caused a nasty clash in the Bank's board. Disgruntled shareholders grumble that Mr Wolfowitz's concerns about Congo's debt relief were voiced only at the last minute, after a newspaper report that the country's president racked up an $81,000 hotel bill on a trip to New York.

Moreover, a policy that consists only of blocking loans could even cause harm. Without guidelines, risk-averse bureaucrats may simply turn down all loans that Mr Wolfowitz might jump on. Corruption, at least of a petty sort, is endemic in most poor countries, so the logical result of a zero-tolerance policy might be no loans at all.

Aux armes

Mr Wolfowitz needs a rigorous battle plan. But where to focus his efforts? Corruption ranges from the billions siphoned to Swiss banks by kleptocratic elites to the paltry bribes paid to local officials. Although different types of graft are easy to identify, the scale and damage they cause is not. Most corruption indices rank countries on people's perceptions rather than objective criteria. Hence the Bank's experts need to create more objective and nuanced gauges of graft.

Mr Wolfowitz also needs to lay out guidelines governing the Bank's lending. Just how much graft is tolerable in a country before the Bank pulls the plug? One approach is to concentrate on the vulnerable parts of the economy. The Bank already seeks transparency in oil and other extractive industries. It should demand equal scrutiny in public infrastructure, such as road building. And where countries score badly, it should not lend money.

A comprehensive anti-corruption strategy demands stamina. Mr Wolfowitz is bound to encounter bureaucratic nitpicking and opposition, particularly from those shareholders, whether China or even France, that are none too bothered about the odd bribe. But if he is serious about battling graft, he must persevere. Wars are won by careful planning, not shooting from the hip.

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On Kazakhstan, irrelevance theory, baggage, Russia, Germany, wine, animals, easy living

Mar 2nd 2006
From The Economist print edition

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FAX: 020 7839 2968 E-MAIL: letters@economist.com

A killing in Kazakhstan

SIR – Your article on the killing of Altynbek Sarsenbaev, a former minister and a leading member of the Kazakh opposition, is right to point out that his tragic death is shocking news for the authorities as well as the opposition ("And then there was one", February 18th). Kazakhstan has made great strides in recent years, in both political and economic terms, and this incident is deeply hurtful to the country. The timing is particularly damaging, coming on the eve of the unveiling of a new chapter of reforms designed to deepen democracy and strengthen Kazakhstan's nascent civic institutions. The government is united with the opposition in condemning the killing of one of the country's most gifted politicians and his murder will not go unpunished.

The president has called for an urgent inquiry and the Minister of the Interior has offered a reward of $75,000 for information leading to the capture of the perpetrators of this crime. An investigation is under way and a number of suspects have been arrested. So as to ensure the complete transparency of the inquiry, the government has officially requested the assistance of the American State Department and the FBI, whose agents' criminal expertise is second to none.

Erlan Idrissov
Ambassador for Kazakhstan
London

The relevance of irrelevance

SIR – You misunderstand the nature of the "irrelevance theory" of Franco Modigliani and Merton Miller (Economics focus, February 11th). Their point is not that a firm's financial structure should be irrelevant in practice; instead it is that capital structure would be irrelevant in a world of perfect markets, and thus the search for the optimal structure should focus on market imperfections. Indeed, Modigliani and Miller themselves relax the perfect markets assumption when examining the effect of taxes on capital structure. They certainly did not "set back for a generation the study by economists of corporate finance". In fact, Jean Tirole, whose book you were reviewing, actually praises the Modigliani and Miller result as a "detonator for the theory of corporate finance, a benchmark whose assumptions needed to be relaxed in order to investigate the determinants of financial structures".

David Goldreich
Associate professor of finance
Rotman School of Management
University of Toronto
Toronto

Baggage claims

SIR – If airlines are serious about wanting to save fuel by encouraging passengers to travel more lightly they should charge passengers on a per-kilo basis ("Light up", February 11th). I am routinely seated next to people whose body weight exceeds my own by much more than the permitted baggage allowance.

Gary Holton
Fairbanks, Alaska

SIR – So some airlines are going to penalise passengers who want to check their bags. Have they taken into account the injuries to customers resulting from the brutal battles for increasingly scarce space in overhead compartments that will undoubtedly follow?

Spud Schreiber

Portland, Oregon

Time to catch up

SIR – I think *The Economist*, along with other western media, exaggerates the influence of non-governmental organisations in Russia ("Vladimir who?", February 11th). Most NGOs cut their teeth on the fall of the Communist regime, but some still think of themselves as "kingmakers" today even though their punditry harks back to that era. They have little to do with the reality of current Russian politics and it is almost impossible to find a report of theirs worth reading. We are at a crossroads in modern Russian history that will be defined as either post-communist or post-democratic. Despite the rise of anti-democratic pressure from the government over the past five years, it is only now that NGOs are paying attention.

Edward Semenov
Moscow

Defective democracy

SIR – You rightly point out that it is good policy to support democracy everywhere, including the Middle East ("The one thing Bush got right", February 4th). However, you also observe that democracy does not guarantee wise choices by using the example of Germans voting Hitler into office. I would like to point out that support for Hitler was already in decline when the old power elite decided to make him chancellor in January 1933 in the belief they could control him. The March 1933 elections took place under Nazi rule and were marred by brutal repression of leftist parties and intense propaganda. Nevertheless, the majority of Germans still did not endorse the Nazi party, which polled 44%.

Michael Meyer-Resende
Democracy Reporting International
Berlin

Best or wurst?

SIR – As an agri-business economist, Bavarian exile and somewhat civilised eater (and drinker), I read your article on German wine with disbelief ("Wine-swilling hordes", February 18th). The German Wine Institute's decision to offer *Weisswurst* (a boiled sausage made from fresh veal and seasoned with parsley) with wine at football stadiums during this year's World Cup is inexplicable. The dish is a regional German speciality, not commonly appreciated north of the Main river. It is eaten almost only as a second breakfast or an early lunch (ie, when no football matches are scheduled) and is rarely consumed with wine. Be assured, whatever will be on offer at the over-commercialised World Cup showtrain, neither wine nor *Weisswurst* sales will soar this summer—not even if Germany should happen to win the tournament.

Christian Fischer
Bonn, Germany

Animal rights

SIR – I vigorously support selling the rights to name new native species ("Names for sale", February 11th). In fact, I would take the integration of economics into the animal kingdom a step further and suggest that endangered species be given a copyright interest in their own images. If Madonna can keep her picture off websites and shirts, why can't today's rhinos, tigers and elephants (or the agencies working on their behalf) collect a small fee when they show up on TV or in a film? Seeing as Disney had its copyright to Mickey Mouse extended by an extra 20 years, isn't it time to give endangered species their chance at a longer life as well?

James Logan
Candia, New Hampshire

Survival of the sloth

SIR – I was heartened to read that the weight gained by a father marmoset during a mother's pregnancy is a sign of care and concern for the incipient baby ("Big daddy", February 4th). Could you find another example, perhaps involving Sunday naps or beer, to demonstrate my evolutionary prowess to my wife? She'll be thrilled.

Ted Ladd
Jackson Hole, Wyoming

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Sunnis and Shias

Does it have to be war?

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EPA

Iraq is the obvious example, but not the only one, of new and alarming hostility between the two faiths

EVEN before the invasion three years ago, there were warnings that the shock of violent change could fragment Iraq into ethnic and sectarian parts. Iraqis themselves have tended to dismiss such fears. But the spectre of a civil war, pitting the historically dominant Sunni minority against the newly enfranchised Shia majority, is now looming, most alarmingly.

In the early morning of February 22nd, saboteurs overcame guards at the Askariya shrine at Samarra, north of Baghdad, an important site of Shia pilgrimage. The explosives they planted did more than destroy the gilded dome that hoods the tombs of the 10th and 11th imams in what most Shias believe to be a divine chain of leadership among descendants of the Prophet. The bombs ignited an unprecedented spate of sectarian bloodletting. At least 500 Iraqis have lost their lives in the past week alone, cut down by suicide bombs or summarily shot, for no reason other than that they belonged to a different sect from vengeance-bound vigilantes.

The current upsurge in violence may yet be contained. Some Iraqis even speak of the events as a wake-up call that could prompt a general retreat from the precipice. But there is a seeming inexorability to the circle of attrition that began in August 2003 with the bombing of another Shia shrine, the mosque of Imam Ali at Najaf, which killed a prominent cleric and some 85 of his followers.

Calls for calm from Shia leaders, effective at first, lost their appeal over time. Shadowy Shia groups began to hunt down individual Sunnis. One recent scandal revealed the existence of an underground prison in central Baghdad, where Iraq's interior ministry, now led by members of a Shia political party, routinely tortured scores of suspected Sunni insurgents. Militant Sunni factions, bent in their turn on revenge, have caused even greater grief. Accusing Shias of collaborating with Iraq's western occupiers, they have targeted them singly and in groups, at mosques, funerals, bus stations and anywhere frequented by the nascent police force largely manned by Shia recruits.

The violence has clearly driven a wedge into Iraqi sensibilities. In each election since the toppling of the Baath party, voters have opted in ever-greater proportion for parties with explicitly sectarian platforms. These parties have taken over government ministries, and turned them into fiefs manned by their supporters. In regions such as the environs of Baghdad, where the two sects overlap most closely, sectarian slayings have prompted fearful households to move to zones where their own sect predominates—a sparse but grim evidence of ethnic cleansing.

Things might not have turned out this way, were it not for the sequential misfortunes of recent history. Discrimination against Shias was pervasive but generally mild before the cruel and turbulent rule of Saddam Hussein. His regime, dominated by Sunni clans from his home town of Tikrit, not only persecuted religious Shias, but systematically crushed alternative bases of Sunni power. Its collapse left Sunnis, many of whom were bitter

opponents of the regime, with no credible leaders to resort to except for religious ones.

A recent, authoritative report by the International Crisis Group explains how three subsequent years of occupation aggravated such divisions. It notes, for example, how American administrators alternately overestimated the influence of the secular Iraqi politicians they favoured, and unwittingly empowered religious factions by applying sectarian formulas to government appointments.

Iraq's experience may be unique, yet it is far from being the only example of tension between Sunnis, who make up 85% of the world's 1.5 billion Muslims, and the multiple sects of the Shia minority. In places as far apart as Pakistan and Lebanon, a centrifugal momentum appears to be exacerbating sectarian feelings. The emergence of revolutionary Iran as an ambitious Shia regional power, and potentially as a nuclear-armed state, has combined with the coming to power of Shias in Iraq to encourage greater assertiveness by Shias in the many countries where they have been historically disenfranchised.

This, in turn, has aroused the awareness of Sunnis to what many see as strangers in their midst. Shia empowerment has been matched by the evolution of radical Sunni chauvinism. Saudi Arabia's Wahhabists, for example, have always taken a dim view of Shias, but this has been amplified by the country's oil wealth (which happens to be in the region where Shias live), and twisted by some into the violence of terrorist groups, such as al-Qaeda.

Living together, amicably

In fact, throughout most of Islam's 14 centuries, the Shia-Sunni divide has been peaceful. Geography, for one thing, largely separates the sects. Both the far west and east of the Muslim world are solidly Sunni. Moroccans or Indonesians hardly know what a Shia is. Egyptians or Bangladeshis have little knowledge of what Shias believe. Shias have tended to cluster in small, often isolated communities in the centre of the Muslim world—in the Levant, the Indian subcontinent, Yemen and the Gulf—and on the Arabic-, Turkish- and Urdu-speaking fringes of historic Persia.

In terms of basic rituals, such as prayer and fasting, the two are not radically different. Before the modern era, the practice of Sunni Islam in many places was imbued with folk beliefs, such as veneration of Sufi saints, that softened the contrast with Shia customs. In mixed cities such as Baghdad and Beirut, the sects often intermarried. Some Iraqi tribes include clans from both. And while at times Shias have thrived under Sunni rule, in Mughal India for example, Sunnis fared well during the reign of the Fatimids, an illustrious and tolerant Ismaili Shia dynasty that ruled Egypt, the Levant and the heart of what is now Saudi Arabia from the 10th to the 12th centuries.

More recently, concerned Muslims have made sincere attempts to reconcile the branches. In 1959, for example, the Grand Sheikh of Cairo's al-Azhar University, the foremost seat of Sunni scholarship (founded, incidentally, under Fatimid rule), issued a fatwa that officially recognised mainstream Shiism as a legitimate school of thought.

AP

Tit-for-tat wrecks a Sunni mosque

In India today, the Shia scholar, Maulana Kalbe Sadiq, has won a large following among both Sunnis and Shias with his passionate calls for Islamic ecumenism. Mr Sadiq often declares that the two branches share 97% of their beliefs, cautioning that extremists from both sides are as big a danger to Islam as its infidel enemies. Both Sunni and Shia leaders in Iraq frequently call for national unity. Less comfortingly, evidence has emerged of radical elements in the Iranian regime giving furtive aid to extremist Sunni groups, allowing the passage of some al-Qaeda members from Afghanistan to Iraq.

Yet the danger of conflict has always existed, ever since the murder, 29 years after Muhammad's death in 632AD, of the Caliph Ali, who was the Prophet's son-in law and the father of his grandchildren, Hassan and Hussein. The word shia derives from the Arabic *shi'at Ali* or the partisans of Ali, and referred at first to the political faction that believed leadership of the Muslim community should remain in the hands of the Prophet's family. When the caliphate passed instead to a rival branch of Muhammad's tribe, other disgruntled groups, including many non-Arabs recently converted to Islam, joined the Shia cause, which drew further emotive strength following the martyrdom of Hussein at the hands of a Sunni army.

How it all began

Over time this political division deepened into doctrinal splits, with each branch elaborating its own interpretations

of *sharia*, or religious law. Sunni Muslims preserved their unity by coming to accept four rival, but equally valid legal schools of varying rigour. Shia Islam followed a different course. It continued to split into subsects over questions of whom to recognise as the imam, a leader whose blood links to the Prophet were held to render him an infallible interpreter of God's will.

Whereas the Zaydis in Yemen recognised only five succeeding imams, Ismailis recognised seven, and Jaafaris 12, before the line of the imamate passed into occlusion, meaning that the imam is hidden but will one day return. The Jaafari, or Twelver branch now predominates among Shias, while most Ismaili communities are small and scattered, although esoteric offshoots of Ismailism, such as the Druze and Syria's Alawites, remain concentrated in the mountain redoubts of the Levant, their historic refuges from persecution.

While often remote from each other in beliefs, all these Shia sects retain relatively defined clerical hierarchies. The Jaafaris, who make up around nine in ten Shias, sustain a loosely church-like clergy through the application of a tax. The faithful are expected to pay one-fifth of their personal profits every year to whichever of several rival ayatollahs they choose as a *marja*, or source of authority. This tax base has given the Jaafari clergy both power and independence, while the pressure of constituents' choice has pushed them towards relatively innovative interpretations of scripture. In imposing laws over such things as inheritance and marriage, their rulings appear sometimes to be guided by practical considerations as much as by sanctified texts.

Sunni clerics in Iraq have tended to view the pursuit of *jihad* against the occupation as a binding religious obligation, but clash with each other over how best to pursue it. Most Shias, by contrast, have bowed to the quiet words of Grand Ayatollah Ali al-Sistani, the country's foremost *marja*. His counsel has been that although infidel invaders are a threat, their presence is likely to be temporary, so there is no need to oppose them physically so long as their presence brings some benefit.

Clerical agendas

There is a powerful subtext to such arguments. The main benefit that the ayatollah has in mind is an end to centuries of Sunni domination, culminating in Mr Hussein's brutal suppression of the 1991 Shia uprising. And the underlying fear that provokes violent Sunni resistance is no longer of becoming an American colony, but of being swamped and politically marginalised by the 60% Shia majority, which is supported by non-Arab Iran.

Among a growing number of extremist Sunnis, there is a further fear, which is that Shias are a sort of fifth column, whose historical mission it is to undermine the faith. Ultra-puritan Sunnis, known as *takfiris*, denounce the Shias as apostates from Islam, and claim that it is therefore legal to kill them (incidentally, it is *takfiri* mosques that the Shias now claim they are targeting in revenge). Radical Iraqi insurgents, aligned with al-Qaeda, have inflicted the most horrific casualties not on American troops, but on unarmed Shia civilians.

Belief in Shia perfidy has prompted discrimination against Shia communities in other places. Vicious sectarian attacks in Pakistan targeting the country's 20% Shia minority (costing 4,000 lives over the past two decades) are often explained by their perpetrators as being a weapon against Indian infiltration via imagined agents. Sometimes, the attacks are ascribed to Indian saboteurs in the first place.

Reuters

Shias in Kashmir lament what happened in Baghdad

Saudi Arabians are inclined to excuse discriminatory practices against the kingdom's 15% Shia minority, such as denying them promotion in government service, on the grounds that Iran, or perhaps America, wants to enlist them as part of a plot to grab the huge oilfields that lie along the largely Shia-populated Gulf coast. (But this does

not explain the even starker persecution of the small Ismaili Shia community that lives in the oil-free south of the kingdom.) A worry that the 60% Shia majority in the small island state of Bahrain will rally to the command of foreign ayatollahs is one reason that keeps the country's Sunni ruling family from granting its citizens greater rights. Similar paranoia may be what prompted the Egyptian authorities in 2004 to arrest leading members of the country's minuscule Shia community, and hold them under the country's emergency laws.

In the case of Lebanon, such fears are less self-serving and more concrete. The poorest of the country's many sects, the Shia emerged during the 1975-90 civil war as a highly organised force, largely due to the tenacity and discipline of Hizbullah, the militia-cum-party that took the lead in hounding Israel out of its long, messy occupation of the Shia-dominated south. But Hizbullah's main supplier of arms and cash is Iran, whose supreme leader, Ayatollah Ali Khamenei, the party officially recognises as its spiritual *marja*. In opposition to the anti-Syrian trend that has swept Lebanese politics over the past year, Hizbullah remains loyal to Syria, because Syria is allied to Iran. Many Lebanese, including quite a few Shias, now accuse the group of holding the country hostage to Iranian policy, particularly during the current stand-off between Iran and Israel.

Examples of recent sectarian hostility proliferate. In India last year, Shia Muslims broke away from a long-established board that governs Muslim family law to establish their own board. Shortly afterwards, three people were killed in a communal riot in the mixed, hitherto quiescent city of Lucknow. In sleepy Kuwait, where Shias have formally protested that their 30% share of the population is not matched by a similar share of top posts, Sunni militants sprayed a Shia mosque with gunfire.

It's politics, stupid

Yet taken together, what all these examples really show is that the essential splits between Sunnis and Shias, beginning with their original schism, have had far more to do with politics than with doctrine. If Shias have been cast as traitors, it has been because their survival depended on internal unity, and occasionally on aligning themselves with stronger powers.

As for the fear, expressed by Jordan's King Abdullah at the end of 2004, of the formation of a "Shia arc" stretching from Lebanon through Iraq to Iran and the Gulf, it might be noted that the Shia themselves do not necessarily share common political interests. Iran, for instance, has often favoured "Christian" Armenia in its nasty and continuing border disputes with "Shia" Azerbaijan. Many Iraqi Shias are perplexed and dismayed by the enthusiasm of their Lebanese brothers in Hizbullah for perpetual "resistance" against the Great Satan which, after all, rescued them from Baathist rule.

The Shia clergy themselves are hardly united, and seldom have been. Throughout much of the 19th century gangs backing rival ayatollahs clashed in the holy city of Najaf. Bitter debate has persisted in modern times over the crucial issue of relations with the state. Ayatollah Khomeini, the father of the Iranian revolution, aroused fierce opposition from other *marjas* with his declaration of *Velayet al Faqih*, or the rule of the jurisprudent, which was, in effect, a ruling that only learned religious scholars were qualified for worldly power. Even within Iran, many clerics believe closeness to power has tainted rather than embellished their reputation. And in Iraq, part of Mr Sistani's reluctance to commit his followers to *jihad* rests with his unwillingness, as a matter of principle, to take on the mantle of military command.

The likelihood of a grand Shia alliance, then, is slim. And since Sunni-Shia differences are largely political, they are surely also possible to resolve. Yet there is a rising sense in both communities, and not only in Iraq, of some kind of impending historical showdown.

One obvious factor is the upsetting of old balances by the intrusion of western power, not only in Iraq, but in Afghanistan and more widely, through the global campaign against Islamist terrorism. But this intrusion was in turn largely provoked by something else, the radicalisation of large numbers of Sunni Muslims, fired by ideas of a return to "pure" Islam and of uniting Muslims into a single nation modelled on the early caliphate.

The most famous proponent of such ideas, Osama bin Laden, has always carefully refrained from any reference to the Shias. Yet he and many fellow-travellers adhere to a school of thought, influenced by Saudi Wahhabism among other currents, which holds the rival sect to be an elemental threat to Islam as a whole.

AP

Before their overthrow, Mr bin Laden's protectors in Afghanistan, the Taliban, mounted merciless pogroms against that country's Shia minority, the Hazara, on purely doctrinal grounds. It is the parties in Pakistan most closely aligned to al-Qaeda that have bombed Shia mosques and torched Shia villages, simply because they hold the Shia to be infidels. Mr bin Laden's lieutenant in Iraq, Abu Musab al-Zarqawi, refers to Shias as *al-Rafida*, a Wahhabist slur meaning rejectionists or turncoats. They are the near enemy, as opposed to the American far enemy, he says, "and far more destructive".

The vast majority of Sunni Muslims find such notions as repulsive as anyone, yet even milder forms of Sunni chauvinism have had nasty effects. Pakistani analysts, for instance, tend to trace the origin of communal strife to the 1980s, when General Zia ul-Haq, then in power, tried to bolster his legitimacy by imposing Islamic law. The trouble was that his laws were those of the Sunni majority, and met with protest from Shias. Their resistance, in turn, provoked radical Sunnis to form vigilante groups, which in some cases recruited among peasants working on large, Shia-owned estates. The result was tit-for-tat killings, culminating in a series of bloody bomb blasts at Shia mosques.

His future in jeopardy

The lesson to learn from all this

If there is a lesson in Pakistan's experience, it is one that Mr Sistani, as well as many Sunni leaders, would recognise. It is that it is a bad idea, especially in a confessionally diverse society, to bring religion and state too close together. That appears to be a lesson that other Muslim societies, where political expression often takes a sectarian course, will have to learn the hard way.

Luckily, the extreme example of Iraq remains an exception. Even there, what underlies the impulse to adhere to sectarianism is the fact that alternative possibilities of political allegiance have lost credibility. That is a temporary phenomenon, a result of the failure of secular parties and leaders such as Mr Hussein. In time, Muslims of both sects, who now cling to political manifestations of Islam, may find that the common ground of secular politics is a better place to contest their rights.

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Iraq

The killing fields

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As Sunnis and Shias fight each other on the ground in Iraq

Get article background

CIVIL war hasn't begun in Iraq yet, at least not in the open way many feared imminent last week after the bombing of the Shia mosque at Samarra. But the tide of sectarian killing, ending several hundred lives, that followed the bomb blast has made the prospect worryingly real.

To thousands of bereaved Iraqis, the war was already upon them, even before the shrine was bombed. After it, Shias were killed at random by Sunnis manning road-blocks. Others were killed in their tightly packed slums by rockets and mortars. Sunnis were executed by Shia militias, who also seized or attacked at least a score of Sunni mosques and murdered more than half a dozen Sunni clerics. Many of the bodies at Baghdad's main morgue had been shot in the head, in the back, or garrotted.

American and Iraqi troops prevented worse violence, as did a 20-hour curfew that lasted for four days. Within hours of the bomb, Iraqi soldiers, under their own instruction, guarded mosques and manned checkpoints. American forces were at first often confined to their bases. But hours later they were thickly deployed in Baghdad, with combat soldiers working 12-hour shifts.

In western Baghdad, only two mosques, both Sunni, were damaged, though eight formerly Sunni mosques were seen flying black Shia flags. In southern Baghdad, which has few Iraqi troops and is a hive of mainly Sunni insurgency, scores of Shias were killed. Eastern Baghdad, including the vast slum of Sadr City, named after the clerical father of a radical Shia leader, Muqtada al-Sadr, witnessed mass protests, serious damage to, or the takeover of, dozens of Sunni mosques, and reports of kidnappings and executions by Mr Sadr's militia, the Mahdi army.

In Baghdad's poor, western Shula district, hung with Shia holy flags, the charred wreckage of two cars parked outside a primary school signalled the seventh mortar attack on the district in a week. "You cannot protect us and our government cannot protect us," a retired army colonel who lives locally told American soldiers at the scene. "People feel very frustrated and some cannot control their frustrations."

As so often happens when Iraq experiences a particularly horrific few days, politicians and religious leaders piously called for national unity. Among the loudest voices was that of Mr Sadr, a man adept at turning religion and nationalism, violence and patronage, to his advantage. Mr Sadr was out of the country when the shrine was destroyed. He swiftly returned, to rally the ragged Shia masses in Basra and Baghdad, and to find his black-shirted fighters seizing mosques and committing murders. After holding talks with Sunni clerics, Mr Sadr played peacemaker, offering his fighters as guardians of the Sunni mosques that they had stolen. To cement their tentative alliance, Mr Sadr and the Sunnis agreed that America had been behind the shrine's bombing, with, of course, Israel's support.

Sectarian violence, pitting Sunnis against Shias, and Sunni Arabs against Kurds, has been the insurgency's main subtext. The violence wells from multiple grievances, beginning with Shia and Kurdish resentment of the Sunnis who profited from Saddam Hussein's patronage. Many Sunnis, to whom Mr Hussein gave stolen Shia and Kurdish property, have now themselves been violently dispossessed.

After America removed Mr Hussein, and dismantled the vestiges of his state, including his army, Shia militias (some of which had fought on the enemy side in the Iraq-Iran war) rushed in to fill the void. Unsurprisingly, the first half-decent Iraqi force that America managed to raise to fight the insurgents, the paramilitary units under the control of the interior ministry, has turned out to be strongly influenced by Shia militias.

The interior ministry troops have been accused of many of the atrocities committed in the relentless tit-for-tat killing against Sunni insurgents. A notable example of Sunni violence was the murder in April 2005 of at least 58 Shia villagers near Salman Pak, south of Baghdad, their corpses thrown into the Tigris river. By May, the Shias were clearly taking reprisal. Several prominent Sunni clerics were murdered, and by January this year, according to one estimate, 60 Sunni imams had been killed since the fighting began.

Sunnis are terrorised by these incidents, just as Shias are terrorised by insurgent attacks. In this atmosphere, false reports of sectarian threats and attacks are abundant in Baghdad and elsewhere. It doesn't make much difference. Fact and rumour combine to create a fearsome atmosphere.

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Six months after Hurricane Katrina

Will there always be a New Orleans?

Mar 2nd 2006 | NEW ORLEANS
From The Economist print edition

Reuters

The city is in limbo, not to mention intoxicated. But hard choices will have to be made—and George Bush still has hard questions to answer

KEVIN FARRER is a connoisseur of festivals. He attends several each year, all around America, to warn revellers that they risk burning in Hell. But he has to admit, standing on Canal Street with a judgmental placard about various deviants and a badge that reads "God hates Mardi Gras", that New Orleans's annual knees-up is in a class of its own.

As the born-again roofing contractor from San Francisco waxes wrathful about the sinners before him, Kay King, a 57-year-old mother of two in a shiny blue miniskirt and outrageous wig, walks up and poses coquettishly beside him. She was offended, she explains later, by Mr Farrer's homophobia. The spirit of New Orleans is one of tolerance, insists Ms King, and neither storms nor street preachers should be allowed to crush it.

Six months after Hurricane Katrina, New Orleans is defiantly on the mend. The Mardi Gras crowds were smaller than last year, but given that the city has lost half its population and a third of its hotel rooms, that was better than expected. The floats were as gaudy as ever, and the revellers were better behaved.

Some marchers made jibes at the government's tardy response to the hurricane by, for example, parading wrapped in red tape and not much else. For others, the act of partying was itself a political statement. The party went so well that it seems churlish to ask, as one of the hellfire preachers did, through a megaphone over the hubbub: "What about tomorrow?"

The question deserves an answer. Hurricanes Katrina and Rita spread devastation across a large swathe of the Gulf Coast, but the trauma is worst in New Orleans. The city was shrinking even before the storm: its population fell from 628,000 in 1960 to 485,000 in 2000. Katrina drove practically everyone out of New Orleans. Nearly half are still in exile, and no one knows how many will eventually return. Most would probably like to, but whether they do depends on several things. Will they have somewhere to live? Will they have jobs? And do they think New Orleans itself will recover?

There are many positive signs. The floodwaters, which covered four-fifths of the city for three weeks, are long gone. So are the looters, though their legacy remains, in bitter memories and dark jokes of the "I stayed in New Orleans for Katrina and all I got was this lousy T-shirt, a new Cadillac and a plasma TV" variety.

Power and water are flowing again, at least to houses that were not wholly destroyed. About half the city's businesses are up and running, though few are near full capacity, because so many of their staff and customers are elsewhere, says Michael Olivier, the head of a state body called Louisiana Economic Development. Milton Jackson, who owns a landscaping business, says he'll start attending properly to his customers once he's fixed up

his family home.

Federal aid to the Gulf Coast has been substantial, with some $100 billion appropriated or proposed, but New Orleans will receive only a fraction of this. Many in New Orleans complain that less damaged but more politically influential places, such as Mississippi, are getting more aid than they really need.

Some good may come of the storm, for it has forced people to think in new ways. For example, most of the schools that have re-opened have done so as charter schools. That is, pushed by impatient parents, some public schools have broken free of the dysfunctional school bureaucracy and started operating independently, though with public funds. The old way of doing things has to change, says Mr Olivier, who predicts leaner government, less corruption and a more business-friendly culture.

A Gallup poll published this week found the city's mood to be surprisingly sunny: four in five respondents said they planned to stay in New Orleans, and three-quarters said they were optimistic about the city's future. But that is probably a misleadingly rosy picture. The poll was conducted by calling New Orleans telephone numbers. So it would tend to exclude those stuck in trailers in Texas, unless they are still using their old cellphones.

The same poll suggested that the city's racial mix had changed dramatically, from 67% black and 28% white in the 2000 census, to 52% white and only 37% black. Given the limitations of the polling method, this should be taken with a bagful of salt. But it does suggest a shift that could have economic, political and cultural repercussions.

The hurricane hit New Orleans's black citizens harder than its whites. It was not only poor black areas that were flooded. Middle-class black districts were too, since there is finite high ground in the city, and whites, who were rich first, built on it first.

The city has not yet decided which neighbourhoods to save. The task is made trickier by evidence that much of the Gulf Coast is sinking, and that the hurricanes that lash it are growing fiercer. Some global-warming worriers think it unwise to rebuild New Orleans at all. Nonetheless, the Army Corps of Engineers is to issue a report this month demarcating the flood plain. Homes deemed flood-prone will be tough to insure, which means they probably won't be built, because banks will not lend money without that protection.

Rationally, it makes no sense to rebuild in the most flood-prone areas. But politics complicates this in two ways. First, there is the question of subsidies. The government says it will offer homeowners up to $150,000 each to rebuild, but it is still not clear how the government will decide which areas are safe enough to subsidise building in. Although some politicians recognise the moral hazard of giving people money to live in a flood zone, they may be tempted to do it anyway (and few will want to tell potential voters that they cannot rebuild their homes if they want to).

Second, building a higher, safer city would almost certainly involve changing its racial mix. Since the city is nearly surrounded by water, it cannot easily expand. So unless the high ground is settled more densely than before, which would irk existing homeowners, building higher and safer implies settling for a smaller, whiter New Orleans.

These two issues will be to the fore in the mayoral election on April 22nd. The incumbent, Ray Nagin, who knew why God sent Katrina to New Orleans (to punish America for invading Iraq, apparently) but not how to evacuate the city, has lost much respect. He has also stirred racial tension by promising that New Orleans would remain a "chocolate city". Yet the election is impossible to call because no one knows who will vote. Exiles will be allowed to, by post, but how many will do so?

If New Orleans loses its black majority, it would affect politics. For example, in the relatively white Gallup poll, a majority of respondents thought the biggest obstacle to rebuilding New Orleans was not that the federal government would not provide enough aid, but that the corrupt city government would waste it. Had the sample included more blacks, George Bush would surely have got more of the blame.

In fact, the president's chances of putting Katrina behind him look no better than those of the city. Shortly after Mardi Gras, a video appeared of Mr Bush's final briefing before the hurricane struck, with federal officials warning him of imminent disaster. The president asked no questions but assured them he was "fully prepared". It does not help the White House's claim that the "fog of war" blinded everybody to the magnitude of the disaster.

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The UN's Human Rights Council

A caterpillar in lipstick?

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A slightly better human-rights body causes problems for America

Get article background

The old and the new

Number of seats

UN regional group	Commission on Human Rights (%)	Human Rights Council (%)
Africa	15 (28)	13 (28)
Asia	12 (23)	13 (28)
Latin America	11 (21)	8 (17)
Eastern Europe	5 (9)	6 (13)
Western Europe and Others*	10 (19)	7 (15)
Total	53 (100)	47 (100)

Source: UN

*Includes US, Canada, Australia and New Zealand

"WE WANT a butterfly," John Bolton, America's ambassador to the UN, insisted earlier this year: "We don't intend to put lipstick on a caterpillar and call it a success." After months of tense talks on plans to replace the discredited UN Commission on Human Rights with a leaner Human Rights Council, he plainly believes that is all he has been given in the "final" draft proposal presented to the UN member states by Jan Eliasson, the General Assembly's Swedish president, on February 23rd. America wants to start again; others think they have to accept the caterpillar.

The 53-member commission includes some of the world's worst violators of human rights. Western governments wanted the new council to be smaller, more effective and with members chosen on the basis of their human-rights records. Instead, the new body has 47 members and is open to all (except for the usual guff about "equitable" geographic distribution). Remarkably, the "Western Europe and Others Group" (which includes America and various white Commonwealth countries) will now have fewer members than before (see table).

However, Mr Eliasson has made some improvements. At present, regional groups can present a "clean slate" of candidates, corresponding to their allotted quota of seats, which is then elected *en bloc* by a simple majority of the 54 members of ECOSOC, the UN's economic and social committee. Under the new proposals, candidates would stand individually and would require the support of an absolute majority of the General Assembly's 191 members. Any member found guilty of "gross and systematic" violations of human rights could be suspended by a two-thirds vote of the assembly.

All the countries in the UN would be subjected to regular review. First in line would be the members of the new council, who would be judged in part against the "voluntary" pledges they will be asked to make when they stand as candidates. This may not drive away all the baddies, but, as one senior British official says, "the capacity to embarrass is fairly substantial."

Instead of members being allowed to stay for ever (Russia has been on the commission since 1947), council members would be able to serve only two consecutive three-year terms—though, as America rightly objects, this would hurt the goodies as well. And the new council would meet at least three times a year for a minimum of ten weeks, with extra possible emergency sessions; by contrast the commission meets only once a year for six weeks.

"This is not old wine in new bottles," insists Kofi Annan, the UN's secretary-general. Like Mr Eliasson, he is extremely anxious not to restart the negotiations, which could revive all sorts of issues. "We should not let the better be the enemy of the good," he says. Most UN members and human-rights groups agree. But nobody wants to isolate America, the world's most powerful country, by forcing a vote.

Mr Eliasson pleads that the promotion of human rights is one of the three pillars upholding the UN: "If we cannot agree on a new, more efficient human-rights body, it will have serious ramifications for the whole organisation." Some people want a cooling-off period. But then the council could become embroiled in negotiations on other sensitive issues such as management reform and the budget. And that could make matters even worse.

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Dung into methane

The year of the dog

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Recycling in San Francisco takes a dirty step forward

AP

Natural gas pipeline

CHINA'S year of the dog and George Bush's push for alternative fuel sources have proudly come together in San Francisco. The city is planning to turn the waste of its 120,000 dogs into usable energy.

Known for its environmental consciousness, San Francisco already uses a dozen recycling programmes to divert 63% of its household garbage away from landfills. Ten years ago, it started a scheme to collect 300 tons (272 metric tonnes) of food scraps a day from houses and restaurants, convert these into fertiliser and sell the result to Napa Valley vineyards and to organic farms.

To help it to achieve its goal of no new landfill waste by 2020, the city commissioned a study of where its garbage was coming from and going to. Something surprising emerged: nearly 4% of the refuse collected from homes came from pet waste (almost as much as from disposable nappies). The traditional means of collection results in doggie dung mummified in plastic in landfills, rather than eventually breaking down.

Some Bay Area residents are already using biodegradable bags to collect Fido's droppings but the city decided to take the process a long step further. According to Robert Reed, spokesman for Norcal Waste Systems, the company that collects and recycles the city's trash, "We came back with the idea of mixing it with food scraps and sending the combined degradables to a converter."

Norcal Waste is planning to try out special collection carts and biodegradable bags at Duboce Park, a popular dog-walking place. Along with food leftovers, the dog waste will go into a methane digester, where bacteria will feed on the combination and emit methane to be used as natural gas. Norcal Waste is still deciding which bags to buy, but eventually San Francisco should be able to add another accomplishment to its illustrious history: being the first city to make methane out of dog shit.

San Franciscan dog owners are keen. As a "dedicated recycler", Hayley Goodson, who lives near Duboce Park, is determined to take part in the experiment. Debbie Lum, proud owner of Furball, lives too far away but claims that "if we could dump the poop in a park near us, we would definitely carry the load there." Now Norcal hopes to extend the dung-to-methane project to other pets and to collecting from private homes. Says Mr Reed, "We don't want Muffin the Cat to be left out."

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Abortion and the Supreme Court

A pop quiz

Mar 2nd 2006 | CHICAGO
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The views of Samuel Alito and John Roberts will soon be tested

Reuters

Get article background

TO THE extent that most Americans follow the Supreme Court, February 28th was notable for the appearance before the justices of Anna Nicole Smith—a blonde widow of a rich nonagenarian who complains that she inherited too few of his millions. However, for America's culture warriors, it was marked by another crucial skirmish in the abortion wars.

In a unanimous decision, the court ruled that protesters outside abortion clinics cannot be deemed to be engaged in extortion or racketeering, despite their organising methods and occasional threats of violence. The ruling was certainly a blow to groups like the NARAL Pro-Choice America, which had hoped that organised-crime statutes might keep their opponents away from the clinics; but it was based on a technicality—and thus does not offer definitive proof that the court has become more "pro-life" after the arrival of two conservatives, John Roberts and Samuel Alito.

However, two other recent developments may well force the court to show its hand. The most direct challenge to the status quo is a bill passed by South Dakota's legislature on February 24th that would ban all abortions, even in cases of rape or incest, unless the mother's health is in danger. Doctors performing abortions would face up to five years in prison. The state's governor, Mike Rounds, opposes abortion, but he vetoed a previous ban in 2004 on the grounds that it had little chance of success in federal courts and would in the meantime put the state's other restrictions on abortion in constitutional jeopardy. Mr Rounds is now hinting that he may sign the new version, remarking that "abortion is wrong, and that we should do everything we can to save lives."

If he does sign it into law, legal battles are sure to follow. During the debate over the measure, South Dakota's legislators were told that a donor had pledged $1m to help defend the ban in court. Yet the bill so plainly defies *Roe v Wade*, the 1973 Supreme Court ruling that permits abortion, that some pro-lifers fear the case would force the Supreme Court to rule clearly on that precedent. And although many opponents of abortion are itching for such a fight, others doubt they can win it just yet (five of the nine justices have publicly backed *Roe*).

Many conservatives would prefer a series of cases that would gradually whittle down abortion rights. Hence the importance of the other event—the Supreme Court's announcement on February 21st that it will rule on a national law banning partial-birth abortion methods. These procedures, which usually take place late in pregnancy, are rarely used, but are sufficiently gory to offend most of the public. In 2003 George Bush signed a federal law banning the practice, but lower federal courts struck it down. Now the Supreme Court will decide whether they were right to overrule Congress.

Many anti-abortion groups believe that, unlike a case involving the South Dakota law, this battle can be won in the current Supreme Court. One of the five ostensibly pro-*Roe* justices, Anthony Kennedy, voted with the minority in 2000 to uphold a Nebraska law banning partial-birth abortions. That case lost by 5-to-4, thanks to the deciding

vote of Sandra Day O'Connor, whose place has been taken by Justice Alito. If Justices Roberts and Alito join Justice Kennedy, along with the two consistent conservatives, Antonin Scalia and Clarence Thomas, it would be enough to swing the balance in favour of a ban.

Meanwhile, states are finding plenty of other ways to battle over abortion. In Mississippi, where the rules are very strict already, a committee in the legislature has just voted to ban virtually all abortions. Elsewhere, conservatives are erecting psychological barriers, such as requiring abortion clinics to show women ultrasound pictures of the foetus. And battles are raging over morning-after pills: conservatives want to make them hard to get; supporters of abortion rights want to provide them over-the-counter and require pharmacies to sell them.

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Michael Joyce

The architect

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A conservative every Democrat should study carefully

MICHAEL JOYCE, who died on February 24th aged 63, was hardly a household name, unless you happen to be called Kristol or Podhoretz. The *New York Times* has not yet even bothered to accord him an obituary. Yet Mr Joyce was one of the leading architects of the conservative renaissance that reshaped America over the past 40 years.

A blue-collar Catholic Democrat by background, Mr Joyce more or less invented a new industry: conservative intellectual philanthropy. He ran two of the right's biggest treasure troves—the John Olin Foundation (1979-85) and the Lynde and Harry Bradley Foundation (1985-2001)—and dispensed millions to conservative thinkers.

It was not just a question of doling out cash. Mr Joyce, unlike the bosses of the big liberal foundations, believed in shaking things up. "My style was the style of the toddler and the adolescent", he once said. "Fight, fight, fight, rest, get up, fight, fight, fight. No one ever accused me of being pleasant." The closest Mr Joyce had to a biographer, John Miller, who wrote a book on the Olin Foundation, nicely describes him as "an intellectual among activists and an activist among intellectuals".

Mr Joyce had an uncanny ability to back ideas that seemed wacky at the time, but have since passed into the mainstream. He provided cash for writers such as Allan Bloom ("The Closing of the American Mind") and Charles Murray ("Losing Ground"). He was the eminence grise behind both Milwaukee's school-voucher programme and welfare reform in Wisconsin. And he was an early supporter of providing welfare services through "faith-based organisations", which became the kernel of "compassionate conservatism".

Conservatives naturally revered Mr Joyce—not just for changing the intellectual climate but for keeping many of them out of penury (just check the prefaces of many conservative books). Arguably, though, the people who should study him most nowadays are on the left. Liberal America does not lack cash; nor does it lack people who are prepared to be unpleasant, as a glance at websites like the *Daily Kos* will show. But it has nobody with Mr Joyce's ability to spot unconventional big ideas.

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Texas politics

HBS for Congress

Mar 2nd 2006 | COLLEGE STATION AND WACO
From The Economist print edition

An obstinate Democrat battles on in George Bush's backyard

Get article background

DEBATES don't get much more conservative than the one last week at Texas A&M University. "I will fight for traditional family values," promised Van Taylor, an ex-marine who is hoping to capture the Republican nomination for the congressional seat where George Bush casts his vote. His opponent in the March 7th primary, Tucker Anderson, called for radical tax reform, a repeal of *Roe v Wade*, and a special prison to lock up illegal immigrants.

This contest in a central Texas district, with Waco at its heart, may seem remote, but there is plenty at stake. For one thing, Mr Taylor is the Republicans' only Iraq war veteran running for Congress this year (his platoon apparently helped rescue Jessica Lynch, a photogenic soldier captured by Saddam's men). By contrast the Democrats are fielding more than half a dozen candidates who have served overseas after September 11th, in races from Illinois to Pennsylvania. For the College Station audience, Mr Taylor plays up his duties, with well-oiled lines: "War is a serious thing. I've seen it first hand."

Mr Anderson, a former legislative aide and rancher, can seem a bit stiff as a speaker, in contrast to Mr Taylor's feel-your-pain style. But he speaks from the heart, is a dogged campaigner, and has a few big endorsements (such as the *Dallas Morning News*) in his pocket. Most important, he is an Aggie (a graduate of Texas A&M), in a district where local roots count. Mr Taylor moved from Dallas, where he worked as a consultant for McKinsey, less than a year ago. Though his new home is barely an hour's drive south, that practically makes him a carpetbagger by local standards: a huge weakness.

Still, Mr Taylor has nearly 10 times the money that Mr Anderson has and the Republican establishment expects Mr Taylor to triumph. Whoever wins will face an even tougher challenge: ousting Chet Edwards. In 2004 the Waco Democrat was one of the few in his party to survive a harsh redistricting masterminded by Tom DeLay, the Texan who was then the Republicans' chief enforcer. Despite an influx of conservative voters, Mr Edwards squeaked home by 51% to 47%.

After 14 years in the job, Mr Edwards has earned the grudging respect of his opponents. He makes much of the fact that he is an Aggie too (though like both Mr Taylor and Mr Bush, he also holds a degree from Harvard Business School). The national Democratic Party is not much loved in these parts, but Mr Edwards has a lot more money than his rivals do. He makes no apologies for using his seat on the House appropriations committee to bring home the pork. "I will defend every congressional earmark that I have added for our district," he says, from better housing for Fort Hood soldiers to cleaning up pollution in Lake Waco. Local voters, he argues, want an "independent-minded" man.

If Republicans are to unseat him, they must make inroads with veterans. That will be tough: Mr Edwards is so popular with military types at Fort Hood, America's largest base, that Mr DeLay removed it from his district—a backhanded compliment from the bruiser. Mr Edwards now speculates optimistically that his persecutor's political and legal troubles (Mr DeLay is stuck in a criminal campaign-finance case) will help him win again. "There's no love lost, even among Republicans, for Tom DeLay" in the district, he claims.

In fact, another court case linked to Mr DeLay could have an even greater influence on the race in Waco. The Supreme Court is expected to rule on the validity of Texas's redistricting this summer. If it chucks out the current map, this race and others will be thrown into a tumult.

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America's resurgent capital

The virtue of being dull

Mar 2nd 2006 | WASHINGTON, DC
From The Economist print edition

What will be Anthony Williams's legacy in the nation's capital?

AP

A FRESH bunch of flowers, a teddy bear and an empty Chivas Regal bottle—in memory of a young murder victim—lie on the street outside the DC Preparatory Academy. This patch of north-east Washington, DC, is not an easy place to live, let alone run a school.

Yet the school itself is an oasis of order. Blue-uniformed nine-year-olds look visitors straight in the eye and proffer handshakes. In one class, a sixth-grader called Prince Taylor solves a ticklish maths problem on the overhead projector. His teacher, Julie O'Malley, asks him to explain how he did it. He starts, but she cuts him off because a couple of his classmates are not looking at him. "Remember the rule," says Ms O'Malley. All eyes focus on Prince, who resumes his explanation.

Schools in the rougher parts of Washington have long been among America's worst. DC Prep shows they needn't be. Its pupils are all from an ethnic minority, mostly black. Its budget per head is no more than that of other local public schools. It does not select entrants by academic ability. And yet in 2003-04, its first year of operation, its pupils advanced on average 1.7 "grade equivalents" in reading (ie, they learned as much in one year as a child is expected to learn in 1.7 years) and 2.3 in maths. The secret? Nothing fancy: just getting the basics right. As a charter school, publicly-funded but free of bureaucratic control, it can shun trendy educational theories in favour of discipline, phonics and longer school hours.

Charter schools now educate over a fifth of the students in DC, up from none in 1996. Washington's mayor, Anthony Williams, has championed the experiment, a stance that has not always made him popular with his fellow-Democrats. "Parents should decide," he says, adding that competition from charter schools should "force the [regular public school] bureaucracy to change."

Mayor Williams is not an exciting politician: his only flourish of flamboyance is an accountant's bow tie. He was first elected in 1998 as a political aspirin to cure the hangover left behind by the infamous Marion Barry, who ran down the budget, cavorted in strip bars and was jailed for smoking crack (but still re-elected after his release). Mr Williams, like DC Prep, has got the basics right. He has balanced every one of his budgets (this year, he expects the cumulative surplus to reach $1.5 billion). Crime is down. The middle classes, who fled to the suburbs in the 1990s (when the city lost 5% of its population) seem to be coming back.

Mr Williams's tidying up of the capital—a little like Rudy Giuliani's tidying up of New York—is now so universally acknowledged that the mayor gets little credit for it. Cynics snipe that crime fell in DC as it fell everywhere, for demographic reasons; that it was the housing boom that balanced the budget; and that it is no great achievement to make Washington solvent when the city is home to the greatest cash-spouting entity on earth.

This is surely unfair: rather than surfing these benign trends, Mr Williams could have bucked them (as his predecessors did). Even so, his record has not been perfect. His attempt to assert control over the DC school system was defeated by the council in 2004, leaving most public schools under the thumb of a partially elected but inept school board. And not all the changes brought by prosperity are welcomed by the electorate.

Poor Washingtonians claim that, since the yuppies moved in, they can no longer afford to live where they grew up. In a city that is around 60% black, such gripes inevitably carry a racial undertone. Plenty of Washingtonians think Mr Williams is out of touch with the have-nots. “What [is he] going to do for those who haven't engaged in the economic boom, for the ex-offenders, the under-educated, the poor?” asks William Shelton, a resident of partly-poor, partly-gentrifying Ward 5.

Mr Williams thinks the city needs more middle-class families, not muggers. “The bell curve [of incomes and educational attainment in Washington] looks like a bosom,” he laments. There's a mound of rich people, a mound of poor people and a gap where the middle class should be.

He says he will not run for re-election this year; after two terms, he wants a change. The race to succeed him is shaping up to be the most expensive in Washingtonian history, with the five main contenders having already raised $2.3m. The election is in November, but the vote that counts is the Democratic primary two months before. The two front-runners are Adrian Fenty, a 35-year-old member of the DC council, and Linda Cropp, its 58-year-old chair.

Ms Cropp, who has been in city politics for 26 years, presents herself as an experienced pair of hands who will carry on roughly where Mr Williams leaves off. Mr Fenty is a more energetic door-to-door campaigner, popular among his constituents because he returns their telephone calls. But he lacks citywide experience or sharp ideas. In a speech to kick off his campaign last year, he announced his intention to “move boldly into the future.” As opposed to moving cautiously back to the era of crack, crime and fiscal implosion?

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Lexington

Purple haze

Mar 2nd 2006
From The Economist print edition

Clintonism is alive, well and living in a governor's mansion near you

A FEW weeks ago "The Daily Show"—the fake news programme that has replaced "Saturday Night Live" as the gold standard of American satire—dispatched a fake newsman to interview the governor of Illinois. The interviewer repeatedly stumbled over Rod Blagojevich's name before giving up and calling him "Governor Smith". He urged him to explain his position on emergency contraception—the governor had recently ordered pharmacists to fill prescriptions for the morning-after pill—by playing the role of a "hot 17-year-old". As a final indignity, he asked whether he was the "gay governor". "Is he teasing me or is that legit?", wondered a flustered Mr Blagojevich.

It is easy to poke fun at governors. These are people, after all, who turn every conversation into an opportunity for boosting their states: tell the governor of the Back of Beyond that the end of the world is nigh and he will reply that this is great news for his state because it is always 30 years behind the times. This week more than 40 of these often ridiculed figures descended on the capital to swap ideas and drop in on the White House (where they dined on venison and listened to Aaron Neville). In fact, the winter meeting of the National Governors Association (NGA) brought a draft of fresh air into a stuffy city, not least by showing that many of the Washington elite's most cherished axioms aren't quite so axiomatic after all.

Take the idea that America is sharply divided into two camps—red and blue. Most governors come in shades of purple. Twelve red states (ie, ones that voted for George Bush) are run by Democrats—all of whom have better approval ratings than the president does. Meanwhile, nine Republican governors run blue states—including such liberal behemoths as Massachusetts, California and New York.

Governors also prefer to mix red and blue ideas. Most Democrats now style themselves as fiscal conservatives (if the term "conservative" can still be used to describe a virtue that has disappeared from the national Republican Party). New Mexico's Bill Richardson boasts about cutting taxes. Virginia's Tim Kaine harps on about having been a missionary in Latin America. Kansas's Kathleen Sebelius has proposed a military "bill of rights" to help the families of military personnel. Brian Schweitzer is seldom seen in Montana without a gun (in Washington, he had to make do with denim clothes, a bolo tie and cowboy boots). And most Republican governors are fairly willing to spend public money. Arnold Schwarzenegger has proposed a massive $222 billion public works programme to rebuild California's ageing infrastructure. Mitt Romney wants to give laptop computers to all Massachusetts's high-schoolers and middle-schoolers.

Or take the idea that America is "running on empty"—that the country has run out of both ideas and the energy to implement them. This may be true at the national level: the combination of a huge federal deficit and a bitterly partisan political culture has rendered government catatonic. But the situation is reversed at the state level. Most states have more money than they have had for years (hurricane-ravaged Louisiana is the exception rather than the rule). Most of them have a surplus of clever ideas about what to do with the money (this is a world of task-

forces and initiatives, of research agendas and development projects). And most of them have savvy politicians who are willing to cut the necessary deals to put the ideas into practice.

And those ideas? Prepare to travel back in time to the era of triangulation, health-care task-forces and tedious third-way conferences. In Washington, Clintonistas dream about the Bush presidency being a mere interregnum between Bill and Hillary, but out in the states it is not so much an interregnum as an optical illusion. The Republicans may control more governorships, but Clintonian ideas dominate governors' mansions across the country, from Little Rock to Sacramento.

The governors are still fixated on the same subjects as they were in the 1990s—reforming education, extending health-care coverage, attracting high-tech businesses and even that golden oldie, "reinventing government". Dozens of states—including conservative stalwarts like Oklahoma and Georgia—are providing kindergarten for pre-schoolers (it seems that it takes a village to raise a child after all). Everybody is trying to attract high-income workers by reinforcing "clusters of excellence", investing in "meds and eds" (ie, health care and universities) and establishing initiatives in the "life sciences". In Massachusetts, Mr Romney is introducing universal health care through a combination of sticks and carrots: everybody will be forced to buy health insurance, with poorer people getting subsidies.

It's the healthy eating, stupid

To the extent that any new subjects have been added to the governors' curriculum, they all have a distinctively centrist flavour. One example is climate change. The details vary—windy states favour wind power while corn-growing ones like ethanol—but everybody is waffling about alternative energy. The governors have also embraced a Hillaryish "bossiness agenda"—taxing smokers and telling people to slim. The theme of the NGA conference was "healthy America", with two erstwhile "fat band boys", Bill Clinton and the current governor of Arkansas, Mike Huckabee, singing the praises of salads.

These ideas about reforming this and reinventing that are not necessarily as impressive as they sound. America's governors have spent decades reinventing education without tackling the most important question of all—whether bad teachers should be able to keep their jobs. And centrist governors don't necessarily remain centrists if they make it into the White House. Remember that George Bush first marketed himself as a "uniter not a divider". But to judge from this week, Clintonian centrism has an awful lot of life left in it.

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Brazil

Lula's leap

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From The Economist print edition

AFP

The Economist talks to Brazil's president

Get article background

THE press says he's shed 14 kilos (30lb). His aides confirm more than ten. But there is no doubt about the improvement in the political fitness of Brazil's president, Luiz Inácio Lula da Silva. Last year, Brazil's worst scandal in a dozen years nearly finished him. The polls now predict his victory over likely rivals in next October's presidential elections. Lula does not admit to being a candidate: he may wait until June to declare himself, while his main rivals must leave their current jobs by next month. Yet his frenetic trips around the country inaugurating crowd-pleasing public works make his intentions plain.

Why is he now likely to win? Speaking to *The Economist* in a rare interview, Lula cited over and over what he regards as his twin triumphs: economic stability plus social progress. "How many countries have achieved what we have: fiscal responsibility and a strong social policy at the same time?" he asks. "Never in the economic history of Brazil have we had the solid fundamentals we have now." Brazil is ready for "a leap in quality", he says.

Such a leap is what Brazil—a country with a population (186m) equal to that of the whole of the rest of South America and a land area bigger than all 25 EU countries combined—has been waiting for since the early 1970s, when it was one of the world's fastest growing economies. Then its economy stumbled into debt and inflation, while other emerging economies like China and India began to take off, generating more global buzz. In his interview at the presidential ranch, Granja do Torto, Lula defended a slow and steady approach to growth and promised further reform in a possible second term. "The future", he says, "will be built on strong investment in education and training, with tax relief to encourage new investment, notably in science and technology." Since becoming president in January 2003, he has achieved much of what he set out to do, but has not yet cleared all obstacles to Brazil's great leap forward.

Popular, but no populist

Solid fundamentals are not what the world expected from Lula. His pre-presidential career consisted mainly of leading a trade union that defied Brazil's military dictators, and a political movement, the Workers' Party (PT), that denounced the "neo-liberal" policies of the dictators' democratically elected successors. The victory of a worker born dirt-poor in Brazil's poverty-stricken north-east was celebrated as a victory for poor people everywhere. Yet Lula did not turn out to be a populist like Venezuela's Hugo Chávez. Instead of spending recklessly, reigniting inflation and perhaps defaulting on debt as Argentina has done, Lula clamped down on inflation and saved extra money to pay the debt. "I will not throw away the opportunity the people gave me," he says.

Lula sees himself as a negotiator, not an ideologue. He has befriended both Mr Chávez and the Venezuelan leader's American antagonist, George Bush. On a state visit to Britain next week, he will try to prod the Doha round of global trade negotiations into life.

For a leader adept at reconciling opposites, Lula has proved a surprisingly polarising figure. Disappointed with his orthodox economics, the left wing of the PT has harried the government with "friendly fire", deterring Lula from reforming as boldly as he might have done. Yet, for his foes, Lula remains the party's creature. He allowed the PT to replace experts from the government bureaucracy with loyalists and to abort programmes that had proved their worth. Then came the *mensalão*, revelations that the PT had been funnelling money illegally to both its own congressmen and those from allied parties. Millions had voted for the party because it proclaimed itself above the grubby norm of Brazilian politics. That image is now in tatters. Lula is popular among the poor, say the polls, but has lost ground among Brazilians from the middle class up.

That the mass of Brazilians seems prepared to overlook these misdeeds suggests that Lula got two big things right: the economy and poverty alleviation. Comparing Brazil's vital indicators when Lula took over with the same ones now "is like looking at two different economies", says Vinod Thomas, former head of the World Bank in Brazil. In the autumn of 2002, Brazil's currency, the *real*, plunged, largely because the markets feared Lula's arrival. Inflation, already in double digits, threatened to spike higher and the yield on Brazil's dollar bonds was 25 percentage points above that of American Treasuries. The new government swerved away from disaster. The finance minister, Antonio Palocci, raised the target for the public sector's primary surplus (before interest payments) by half a percentage point to 4.25% of GDP, persuading the markets that Lula could be trusted to pay Brazil's public debt. The central bank steadied the *real* and raised interest rates to choke inflation.

An economy that swooned every time confidence in emerging markets wobbled now looks steadier. Spurred by a devaluation in 1999 and buoyant demand for commodities, exports have boomed, turning a current-account deficit into surplus. Mr Palocci has used the inflow of dollars to pay off foreign creditors, including the IMF. Soon, Brazil will no longer have to worry about a falling *real* driving up its debt burden. The risk premium has fallen to a record low of two percentage points.

An economy that swooned every time confidence in emerging markets wobbled now looks steadier

Much of the grumbling is about the price Brazil has paid for stability. Under Lula, economic growth has averaged just 2.6% a year, barely better than the dismal average of the last 15 years. There are at least three culprits. At around 11%, Brazilian real interest rates are among the highest in the world. Government grabs an estimated 38% of GDP in the form of taxes and contributions, well above the tax take of most other Latin American economies. Even with all that revenue, central government investment has shrunk to a derisory 0.5% of GDP.

Barely a day has passed since Lula came to office without shrill denunciations of the central bank, often from his own vice-president, José Alencar. Tight monetary policy has stifled investment and pushed the *real* to levels that threaten exports and scare local producers. But Lula insists that "you can't make the central bank the villain", not least because the government sets the inflation target. The government is doing its part, for example by reducing import tariffs "on products that we know are increasing in price more than they should", such as steel, he says.

Steady as she goes

Turning to Brazil's crushing tax burden, Lula points out that the government has not raised a single tax rate yet. Revenue is up because profits are higher and tax collection is better. As this improves, "we'll be able to reduce the tax burden by cutting rates and expanding the base of contributors". For Lula, sure growth is worth more than fast growth. "I don't want to grow 10% or 15% a year. I want a lasting cycle of growth averaging 4% or 5%." There will be "no magic in the economy", he says. This year growth should be around 3.5%.

Reuters

Survival, but no exit from poverty

But stability has its own subtle magic. It protects the value of salaries and encourages business to plan long term. "The capital market is now an option" for financing infrastructure, says Paulo Godoy, president of the ABDIB, a group representing infrastructure firms. Despite high interest rates, consumer credit surged after the government let banks lend to consumers against their paycheques. This contributed to what will no doubt be the PT's favourite campaign statistic: 3.5m jobs created in the formal sector between 2003 and 2005.

This points to a second achievement: a reduction in poverty and inequality—the blight that Lula was elected to combat. A poverty index tracked by the Fundação Getulio Vargas (FGV), a business school, fell from 27.3% of the population in 2003 to 25.1% in 2004. Strong economic growth in 2004 helped. More important, says Marcelo Neri of FGV, was a sharp drop in inequality, which is "now at its lowest level in the past 30 years, and still falling."

The reasons for this are complicated and only partly down to Lula. His predecessor, Fernando Henrique Cardoso, universalised primary education, which accounts for much of the reduction in inequality. He also tweaked Brazil's job-killing labour law, encouraging formal employment. Declining informality and inequality are "new elements on the Brazilian scene which analysts don't fully understand," says Mr Neri.

After a stumble, Lula has helped. Upon taking office, he unveiled an anti-poverty programme called *Fome Zero* (zero hunger), which was clearly unworkable. Lula retreated, replacing it with *Bolsa Família* (family fund). This consolidated five pre-Lula programmes that transferred cash to poor families, raised the benefit and expanded the number of beneficiaries so far to 8.7m families, roughly a fifth of Brazil's population. This makes it "the most important income transfer programme in the world", says Lula. In the poor north-east, with the largest concentration of beneficiaries, the programme can mean the difference between hunger and sufficiency and sustain small-town economies.

Bolsa Família draws sneers, too, notably that it provides subsistence, but no exit from poverty. Lula retorts that the conditions attached to the transfer—beneficiaries must keep their children in school and vaccinate their babies—make it more than a handout. "It's an emergency programme," he says. "My dream is that one day we won't need *Bolsa Família* any more because it will have generated employment and aided income distribution."

More lasting is Lula's other gift to the poor, a real 25% rise in the official minimum wage, which also affects publicly financed pensions. Lula claims this is necessary to ensure "that the poorest part of the population has the right to eat". But it does so inefficiently, with a bias toward the elderly. Just 3% of poor families include a pensioner, while 85% have children.

This points to the Lula government's blind spot. The rise in the minimum wage is symptomatic of an overall increase in government spending, one of the main reasons debt, taxes and interest rates are so high. Non-financial spending by the federal government rose from 17.7% of GDP in 2002 to an estimated 18.8% last year, says Raul Velloso, a budget expert. That is part of a deeper failure: to come to grips with a state that is overgrown but is neither efficient nor fair. That omission may well be one of the roots of the *mensalão*, which has blotted the second half of Lula's mandate. Reinventing the state is no simple task, but it is probably the most urgent one facing the winner of October's elections.

Mr Palocci recently proposed a "social accord" to reduce spending and improve its quality. Although he did not spell it out, this would probably involve capping spending as a proportion of GDP, breaking the link between the minimum wage and pensions, and reforming the pension system, Brazil's version of welfare for the rich. Lula's chief of staff, Dilma Rousseff, scorned one version of this idea as "rudimentary", a hint of the resistance it will face from within the government.

Lula says that Mr Palocci and Ms Rousseff differ only over timing. "In an election year it's hard to achieve a social accord," but "in a quieter period everyone will agree that we need a commitment not to spend more money than we can." Lula says that he started the job by reforming civil-service pensions (taxing them, for example) and that a campaign to strike fraudsters from the benefit rolls is paying off. But he may not swallow Mr Palocci's ideas whole. Delinking the minimum wage from pensions, for example, "is easy to say and very difficult to do". As for raising the retirement age, "as longevity increases, the pension system will have to adapt".

The *mensalão* revealed defects of a different sort. It remains a sea of supposition dotted with islands of fact. What is known is that the PT channelled millions of *reais* to friendly congressmen, mainly through an intermediary who doubled as a campaign consultant. Off-the-books campaign financing is illegal, but common. Still unproved are more sensational claims that congressmen accepted the *mensalão* (monthly stipend) in exchange for backing the government and that the money came from state enterprises or their pension funds. A report by a congressional committee later this month may back these claims. Fact and suspicion forced a purge of the PT's top officers along

with the resignation and subsequent expulsion from Congress of Lula's chief aide, José Dirceu.

Lula blames two groups of people: those who perpetrated a "massacre" of the PT with unfounded accusations, and a few bad apples in the PT itself. "You can't judge a party because a half-dozen people made mistakes." Yet he admits that the massacre was "justifiable". The PT "will have a lot to explain to society", he says, avoiding explanation himself.

The *mensalão* crystallised a belief that the PT's historic rise to power was a setback for Brazil's institutional development. Its rise seemed to confuse party with government, injected ideology where expertise was needed and pushed government into areas where it had no business. Lula says encouraging things about withdrawing the state from the economy and professionalising the civil service, but has not done much of either. More disappointingly, "Brazil has done less than expected on education and health," says Mr Thomas. Lula has tended the orchard but planted no new trees, critics say.

There are examples enough to justify these criticisms, from the needless scrapping of the *provão*, an exam used to evaluate universities, to a hare-brained proposal to install government-appointed auditors in independent regulatory agencies. But this demands qualifications. One is that the Lula government sometimes learns from its mistakes. It spent years tinkering with a concession law, during which time no new federal roads were handed over to private management. But under the new law, disputes will be submitted to arbitration, which investors like. The orchard analogy misses some trees. A bankruptcy law, for example, has lowered leasing costs for airlines. A judicial reform should speed cases through the notoriously slow courts.

What other trees might Lula plant? The next president should disentangle state sales taxes, restructure trade unions and "update" labour law to make it "less burdensome for an employer to hire a worker", Lula says. Political reform would discourage future scandals. If "you create a public fund for elections, prohibit private money and you have better control by the electoral authority, you can reduce the errors that a political party can commit." Could it be Lula's destiny to preside over a transition to cleaner politics?

A transcript of our interview with Lula appears at www.economist.com/lula

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Brazil's foreign policy

Lula's world

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From The Economist print edition

Highlights of Lula's views on regional and foreign policy

ON THE Doha round of global trade negotiations: "Brazil is prepared to do its part to be flexible in both industry and in services proportionally to the weight of our economy...We can't simply leave these negotiations to the negotiators," he says, calling for heads of state to settle some of the unresolved issues.

On the proposal for a Free Trade Area of the Americas (FTAA), rejected by some of the region's leftist leaders: "We [Brazil] removed the ideological baggage from the discussion and emphasised instead the reconstruction of Mercosur," a four-nation South American grouping, together with world trade talks. "Neither the United States nor Brazil is making the FTAA a priority."

On Mercosur: "Brazil, as Mercosur's biggest economy, needs to be more generous," he says, citing a recent agreement to create a safeguards mechanism as "a gesture by Brazil to Argentina", the second-biggest member. Relations were once so bad that Argentina's military thought that Itaipu, a giant Brazilian-Paraguayan dam, would flood Buenos Aires. Néstor Kirchner, Argentina's president and he are now "dismantling" this history, he says.

On the United Nations: Lula calls for "deep reform" to take account of "the new geopolitics". As Latin America's biggest country, Brazil is hoping for a permanent seat on the Security Council. Lula recounts how he once questioned China's president, Hu Jintao, about his opposition to a permanent seat for Japan, one obstacle to reform. "We can't allow the problems of the last century to influence decisions that will affect future centuries," he told Mr Hu.

On Venezuela: Lula says he is trying to get Hugo Chávez and George Bush to meet to resolve their differences. "Chávez is convinced that a coup attempt against him was organised to benefit American interests. President Bush doesn't accept that. This will be resolved only if they talk."

On Evo Morales, Bolivia's new president: the election of Bolivia's first indigenous president is "extraordinary", comparable with the advent of majority rule in South Africa. Rather than encourage the army and police to uproot coca from Bolivia, the United States should consider buying it, offering a better price than the drug traffickers. Mr Morales, a leader of radical social movements, would discover that "between theory and practice there is a gulf bigger than the Atlantic Ocean". Lula seemed to be referring to himself as well.

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India and America

Joining the nuclear family

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AFP

A strategic partnership built on shaky and controversial foundations

"WE HAVE made history today," Manmohan Singh, India's prime minister, told George Bush after a joint press conference in Delhi on March 2nd. They had just clinched what Mr Bush likewise called "an historic agreement" on nuclear power. Many critics believe it will prove an historic mistake.

The deal completes an accord the two men reached in Washington, DC, in July 2005, to bring India out of the international nuclear wilderness. Never having signed the Nuclear Non-Proliferation Treaty (NPT), India carried out a nuclear explosion in 1974, and took the world by surprise again by testing several bombs in 1998. Yet last summer America agreed to grant it full civil nuclear-energy co-operation. For India, this was a golden opportunity. As Mr Singh told parliament on February 27th, it offered the possibility of "decades-old restrictions being set aside to create space for India's emergence as a full member of a new nuclear world order".

The deal nearly foundered, however, facing a storm of criticism in both America and India. It was rescued by frantic negotiation, by telephone from Airforce One as Mr Bush's party approached Delhi via Kabul, and overnight once they had arrived.

The difficulty was over India's proposals for separating its military nuclear facilities from the civilian ones, which will be subjected to international safeguards. According to Mr Singh, "our civilian and strategic programmes are deeply intertwined" and India's initial separation plans—keeping almost all its reactors in the "military" basket—were rejected. In later proposals reactors accounting for some 65% of its nuclear-power capacity were listed as civilian. As *The Economist* went to press, details of the final separation plan had not been released. It may show that India has not done enough to help Mr Bush fulfil his offer to amend American laws and persuade other countries to change international rules that prevent nuclear trade with countries that do not accept full safeguards on all their nuclear facilities.

But America's Congress may yet scupper the deal. Being able to import fuel and nuclear technology from abroad—President Jacques Chirac was in Delhi last week to ensure France was in pole position for new contracts—means India can keep expanding both its nuclear power-generation and its strategic arsenal. That is deeply troubling, argued a group of former senior American officials in letters to Congress, in November and again last month, since the United States is committed under the NPT not to assist another state's nuclear-weapons programme "in any way". By treating India as the world's sixth accepted nuclear power, Mr Bush also risks encouraging others to kick over the nuclear traces and may now find it even harder to rein in Iran's nuclear ambitions.

Of particular concern is the new deal's apparent acceptance of India's demand that its experimental programme of fast-breeder reactors (previously said to be for civilian use) should be exempted from international safeguards.

This says a lot about India's ambitions. In 1999, when the Clinton administration attempted to persuade it both to end its production of fissile material for weapons and to sign up to a comprehensive test-ban, Indian officials demurred. Their needs were not infinite, they explained; it would take just a few more years to produce enough plutonium for a credible minimum deterrent.

Now India rejects anything that implies a cap on its strategic arsenal. Last month Anil Kakodkar, chairman of India's Atomic Energy Commission, publicly objected to any constraints on the fast-breeder programme: not in our "strategic interest", he said. These reactors are ideally suited to produce plutonium for weapons.

Leaving these off the civilian list, says Robert Einhorn of the Center for Strategic and International Studies, a Washington-based think-tank, enables India to produce up to 50 bombs a year, if it chooses, instead of between six and ten. Nor has India taken upon itself the "responsibilities" of the five official nuclear powers, as Mr Bush's officials have claimed. All five have stopped making fissile material for weapons, and have at least signed the test-ban treaty. India intends to do neither. Its tightening of export-control legislation is no concession, but a requirement imposed by the United Nations.

There is still plenty of opportunity for the nuclear pact to run into the sand. Besides the risk of America's Congress throwing it out, India may not be able to reach agreement with the International Atomic Energy Agency on the terms of a safeguards agreement. But it did at least provide Mr Bush's visit—only the third by an American president in 28 years—with its big symbolic agreement, marking the president's determination to draw India into a "strategic partnership". Without it, the diplomacy might have been drowned out by the noises off-stage on March 2nd: the big demonstrations against his visit in Delhi by leftists and Muslims, and the murderous bomb attacks near the American consulate in Karachi, in Pakistan, whose capital, Islamabad, Mr Bush was due to visit on March 4th.

As both Indian and American officials stressed, there is far more to their "partnership" than the nuclear deal. Mr Bush was accompanied by a group of business bosses, enthused by India's booming economy. Indeed, there are plenty of opportunities for the world's richest democracy and its largest to cement their friendship. Helping India hone its nuclear skills is hardly a good place to start.

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India's economy

Fast track

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But politics could still apply a brake

Get article background

"GROWTH", as Palaniappan Chidambaram, India's finance minister, puts it, "is the best antidote to poverty." Presenting his budget on February 28th, he was celebrating an economy that has grown by an annual average of about 8% for the past three years. Mr Chidambaram's government now says it wants to see 10% annual growth. But politics still limits its ability to pursue tough economic reforms, without which even the current rate may be hard to sustain.

Still, Mr Chidambaram is entitled to feel smug. Rapid growth, underpinned by a savings rate of 29% of GDP and an investment rate of 30%, has been a great help to government finances. His budget was able to include big spending increases and a return to fiscal prudence. Last year, mindful of promises to spend more on relieving poverty and on health, education and infrastructure, Mr Chidambaram suspended efforts towards fiscal correction, though the outcome was not as bad as he feared. The central government's deficit rose only fractionally, to 4.1% of GDP.

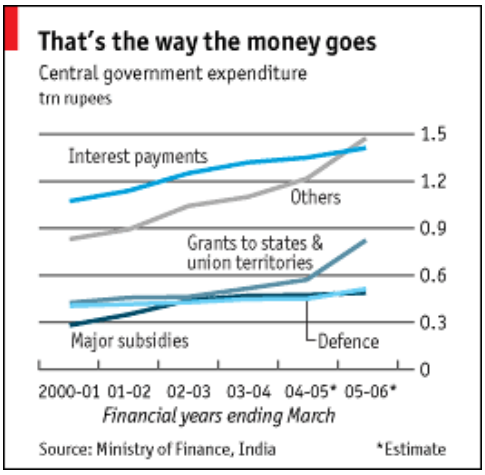
When India's state governments are added in, the overall government deficit climbs sharply, to an expected 7.7% of GDP in the present year. But, at the turn of the decade, it was hovering around 10%, so even fiscal hawks congratulated Mr Chidambaram. For the second year running, he was given credit both by the left, for trying to meet his spending promises, and by reformers, for his commitment to growth.

Mr Chidambaram himself lists four main threats to the economy: high oil prices, rising interest rates, external shocks and "the temptation to stray from the path of fiscal prudence". The government has not passed the full impact of rising oil prices on to consumers. The IMF has estimated the cost of this, mostly borne by state oil companies, as 0.5% of annual GDP in the first half of this fiscal year.

Partly for this reason, inflation, at around 5% a year, remains subdued. Despite this, the Reserve Bank (the central bank) raised interest rates in January. This will help contain the expansion of bank credit, which in the year ending March 2005 was the fastest in Asia, at more than 30%, and of economic growth itself. Indeed, according to figures released this week, the economy is already slowing slightly—to an annualised rate of 7.6% in the last quarter of 2005. This will ease the pressure on India's current account, which after three years of modest surplus is now back in deficit—by as much as 4.6% of GDP in the third quarter of last year.

But the IMF also noted that India's large reserves of foreign exchange ($133 billion) and its capital controls provide a buffer. The bigger danger may turn out to be that India misses opportunities. The present boom should offer the chance for a more rapid fiscal clean-up. Obvious candidates for reform are the inefficient price subsidies—on food and fertiliser as well as petroleum products—that take up 10% of current expenditure (see chart).

Mr Chidambaram urged parliament to reach consensus so that subsidies can be directed at the truly needy. But in a year when there are elections in a number of states, this will not happen. And, while its finances remain strapped, the government will find it hard to plug India's "infrastructure deficit"—in roads, ports and above all electricity. Nor will it be able to deliver the improvements it so badly needs in health and education.



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Taiwan and China

A calibrated provocation

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But China has not fallen into the trap

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IN THE elaborate fiction that governs relations across the Taiwan Strait, there exists in Taiwan a body called the National Unification Council, whose notional aim is to advise the president on how the island and the mainland are to unite, an aim which China and Taiwan notionally share. The body has been inactive for six years. But when President Chen Shui-bian appeared to scrap it this week, he caused anger in China, and worry in America.

Mr Chen has been weakened by scandals in his party but has two years left in office. Appealing to Taiwanese nationalism is one way to rally support. Hence the appeal of scrapping a body that is supposed to advise him on unification. But Mr Chen does not want to provoke China into a military response. So his decision was judiciously worded. The council, he said, had "ceased to function" and its guidelines had "ceased to apply". This phrasing suggests the possibility of a future revival.

The careful wording was also partly intended to pacify America, which has been trying to persuade Mr Chen not to rock the boat since late January, when he signalled his intention to take this step. A spokesman for the State Department said America would "continue to hold President Chen by his commitments not to take unilateral moves". He also said it was America's understanding that Mr Chen had not formally abolished the council.

For all its fulminations, however, China does not seem keen to escalate this particular dispute. President Hu Jintao accused Mr Chen of taking a "dangerous step" towards independence. But officials have not threatened to invoke an anti-secession law passed by China's legislature a year ago. That authorised military action against Taiwan in the event of undefined "major incidents" entailing the island's independence from China. The law has been described by Taiwanese officials as a threat to the status quo and, indeed, a primary justification for Mr Chen's decision.

A bigger worry for Chinese leaders is that Mr Chen might renege on other pledges not to amend the island's constitution. He may suggest that China is a separate country. Worse, he may change Taiwan's official name (the Republic of China). China does not officially accept this name for Taiwan, but much prefers it to the Republic of Taiwan. Given the distinct possibility that the opposition Kuomintang (KMT) will reclaim Taiwan's presidency in 2008, Mr Chen might feel tempted to risk a dramatic gesture in order to rally support for his party.

But as Mr Chen noted this week, any constitutional reform would, under rules introduced last year, require approval by three-quarters of the legislature as well as a referendum. With the KMT and its supporters—who favour keeping on good terms with China and keeping the council—controlling a majority of parliament's seats, this would make it hard to introduce an amendment China strongly disliked. Mr Chen wants a constitutional referendum next year, but has not so far proposed any changes that would rile the Chinese.

An escalation of rhetoric can be expected in the next few days as China's legislature holds its annual meeting, starting on March 6th. Nationalistic outbursts from the Communist Party-picked delegates have become part of the ritual. Unlike the meeting last year at which the anti-secession law was adopted, the focus of this year's agenda will be domestic: in particular a new five-year economic plan which is aimed at reducing a growing gap between rich and poor. But just to be sure that Taiwan stays in line, the meeting will surely engage in another of its annual rituals, a hefty increase in military spending.

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Thailand

Who will blink first?

Mar 2nd 2006 | BANGKOK
From The Economist print edition

Immovable prime minister meets implacable opposition

Get article background

DETERMINED to cling to power despite a growing clamour for his resignation, Thailand's prime minister, Thaksin Shinawatra, has made a series of tactical retreats. First, in January, he sold his family's media and telecoms empire, Shin Corp, to a Singapore government agency, hoping to blunt the opposition's main line of attack—that he was abusing his powers to benefit his businesses. But when it emerged that the Thaksin clan had exploited legal loopholes to avoid tax on the $1.9 billion they raked in from the sale, the calls for him to go only got louder. So he called a snap general election for April 2nd—three years early—arguing that his critics were an unrepresentative bunch and that the Thai people as a whole should be his judge.

But his opponents are proving as implacable as Mr Thaksin is immovable. The three main opposition parties announced on February 27th that they would boycott the elections—which they would probably lose, given Mr Thaksin's continued support among poorer, rural Thais. A few hours later at a rally in central Bangkok, the People's Alliance for Democracy (PAD), a supposedly grassroots anti-Thaksin movement backed by business and political barons who have fallen out with the prime minister, issued an ultimatum: if Mr Thaksin did not quit altogether by Sunday (March 5th), it would step up its protests, a move that could lead to blood on the streets. Mr Thaksin countered by announcing a rally of his own supporters, to be held in Bangkok on Friday, heightening the danger of violence.

Mr Thaksin's position has been weakened, and PAD's strengthened, by the defection of the prime minister's former mentor, Chamlong Srimuang, an ascetic ex-general and Buddhist sect leader. He was one of the driving forces behind the bloody but ultimately successful 1992 popular uprising that brought down the then military government. He promises his "Dharma army" of monks and nuns will not start any trouble but his reassurances are not wholly reassuring. There has been talk of a possible military coup, but the commander of the armed forces insists that his men will remain neutral.

Any bloodshed—whoever starts it—may very well be blamed on Mr Thaksin. If so, it might make his downfall inevitable, just as street violence brought down the government in 1992 and, before that, in 1973. So, on February 28th, the prime minister gave ground once again. He said he was prepared to postpone the election if the three opposition parties wanted that; and he offered to discuss their demand that his Thai Rak Thai party sign a pact with them, pledging to create a "neutral" panel of experts to draft constitutional changes (the opposition has been vague on just what changes they want).

The opposition had used Mr Thaksin's initial refusal to sign such a pact as their excuse for boycotting the elections. However, Korn Chatikavanij, the deputy leader of the Democrats, the largest of the opposition parties, says the prime minister's change of mind has come too late and there is now nothing, short of Mr Thaksin's resignation, that would persuade them to call off the boycott. It is better, Mr Korn argues, to stay out of a political process that the prime minister has "corrupted and warped".

Thai voters, and the outside world, may think rather that the boycott amounts to a dereliction of the opposition's duty to take part in the democratic process. If the election goes ahead, Mr Thaksin will gain an even bigger majority than he has now, and will have to contend only with the few tiny parties that are not joining the boycott. But Thitinan Pongsudhirak, a political analyst who notes that the opposition parties have enough money to fight only one election campaign, reckons they may be saving up for yet another election. This one might come soon, after the protesters have finally forced Mr Thaksin out. If the Democrats and their allies do eventually gain power, they can hardly complain if a time comes when violent, unrepresentative mobs one day try to force them out of office.

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South Korea

A standing reproach

Mar 2nd 2006 | SEOUL
From The Economist print edition

Amerasian pride, and prejudice

EPA

It couldn't happen in Seoul

WHEN Hines Ward, a Korean-American who plays wide receiver for the Pittsburgh Steelers, won the title of most-valued player in American football's Super Bowl last month, South Koreans seized on the sportsman as one of their own. The feting of Mr Ward—born to a Korean mother and a black American soldier stationed in South Korea at the time, and taken to America when he was one year old—has been equalled only by the breast-beating in the local media over the systematic discrimination meted out to people of similar mixed race at home in Korea.

Koreans have always prided themselves on ethnic homogeneity, and feared and distrusted outsiders. Reinforcing this prejudice has been the hostility directed against people who serve as a reminder of the most desperate era in modern Korean history. The first mixed-race children were the offspring of liaisons between Korean women (frequently prostitutes or husband-seeking poor) and American troops after the 1950-53 Korean war.

At one stage this "Amerasian" population is believed to have numbered in the tens of thousands, though many emigrated. In recent years, however, South Korea's mixed-race population has expanded again, and diversified, as farmers and blue-collar workers, unable to find Korean wives, have turned to South-East Asia in search of a spouse. The resulting partnerships with women from countries such as the Philippines and Vietnam are estimated to have increased the mixed-race population to around 35,000, according to Pearl S. Buck International, a charity which works with mixed-race children.

The origins of mixed-race South Koreans may have changed, but the experience of individual and institutional discrimination remains strikingly similar. Children of mixed marriages, often born into poor families, are stigmatised and frequently end up dropping out of school. According to a 2001 survey, their drop-out rate from middle school was 17.5%, against a national average of just 1.1%. Lower qualifications cause higher unemployment, and a concentration of mixed-race Koreans in manual or part-time work.

In the wake of Mr Ward's splendid achievements on the football field, politicians and government bodies have been falling over each other with promises to dismantle discriminatory practices. The Ministry of Defence recently lifted a ban on mixed-race men doing military service, originally imposed in the belief that they would not fit into barracks life. This is important: job-seekers who have done military service are eligible for extra benefits. But for many of the Amerasians, the changes come too late. They ask bitterly whether Mr Ward would have achieved equal greatness if his mother had chosen to stay in South Korea.

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Kazakhstan

The net closes in

Mar 2nd 2006 | ALMATY
From The Economist print edition

A fishy official story

JUSTICE can be astonishingly swift in authoritarian Kazakhstan. Just two weeks after the murder of Altynbek Sarsenbaev, an opposition leader, along with his driver and bodyguard, their killers and the person behind them have been arrested and the crime solved. So says the Ministry of the Interior. A trial date still has to be announced, but all have readily confessed.

Erzhan Utembaev, the top administrative official of the Senate and a former deputy prime minister, has admitted to ordering the murder of Mr Sarsenbaev out of "personal enmity". He was arrested on February 22nd, a few hours after the head of the KNB, the national security service and successor to the Soviet-era KGB, had stepped down because of the involvement of five of his agents of the elite unit Arystan (Lion) in kidnapping Mr Sarsenbaev. A sixth person, a former Arystan officer, oversaw the operation and committed the murder.

The problem with this official version of events is that no one in the opposition believes that Mr Utembaev is capable of devising such an elaborate scheme on his own. Oraz Jandosov, a former deputy prime minister himself and along with Mr Sarsenbaev one of the founders of the united opposition movement, For a Just Kazakhstan (FJK), says he knows Mr Utembaev very well and thinks it "impossible".

Instead, FJK says it believes the murder was ordered by senior government officials and has called on the interior ministry to broaden its investigation. It wants it to interrogate other public figures, including both the president's eldest daughter, Dariga Nazarbaeva, a member of parliament who had a legal dispute with Mr Sarsenbaev, and her husband, Rakhat Aliev, who is first deputy foreign minister. Mr Aliev has called the allegations "vile lies".

With events happening thick and fast, observers believe that the murder of Mr Sarsenbaev, a former ambassador to Russia, marks the beginning of a struggle for the succession to Nursultan Nazarbaev, 65, who was re-elected for another seven-year term last December, and an early attempt to narrow the field.

On February 26th, the opposition staged Kazakhstan's largest protest in years, when more than 1,500 of its supporters defied laws on public assembly and marched on Almaty's Square of the Republic. Again, justice has proved to be swift. Two days later, 11 members of FJK were taken to court for the unauthorised demonstration and given sentences of up to 15 days in prison. No one imagines that this affair is over.

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Chad

The danger of war spilling over

Mar 2nd 2006 | NDJAMENA
From The Economist print edition

Reuters

Chaos in western Sudan is threatening to engulf neighbouring Chad too

THE mayhem in Darfur, in western Sudan, where some 400,000 people may have been killed and 2m-plus displaced, is worsening. The misery is spreading west into neighbouring Chad, unhinging that country and threatening a proxy war with Sudan. What can be done?

It is widely accepted, in Africa and elsewhere, that the peacekeeping force in Darfur under the aegis of the African Union (AU) was hopelessly ill-equipped to succeed in its valiant bid to hold the ring. Hence an appeal last month by the UN's secretary-general, Kofi Annan, for the UN to take over with a force twice the size of the AU's, which was 7,000-strong, provided enough countries could be found to send troops wearing the UN's blue helmets (see article). A role for NATO, as the world's most efficient military alliance, was also widely mooted.

The latest snag is that Sudan's government, which at first sounded glumly amenable to having UN troops on its territory, is now lobbying against it. Jan Pronk, the UN's envoy to Sudan, said this week that the government in Khartoum was damning the idea of UN involvement as a prelude to a western takeover. "They speak about recolonisation, imperialism...they speak about conspiracy against the Arab and Islamic world," he said.

Chad's government does not agree. Two months ago, rebels hoping to depose Chad's strongman, Idriss Déby, drove through neighbouring Sudan in a convoy of brand-new Toyota jeeps and burst across Chad's eastern border near the town of Adré. Plainly egged on by the Sudanese government, they had no trouble passing through Sudan's many checkpoints, from Port Sudan on the Red Sea, a journey of some 1,600km (1,000 miles), to Chad's border. But Chadian troops loyal to Mr Déby, some of them recently trained in counter-terrorism by the Americans, beat off the rebels and chased them back into Sudan.

So far, this scrap among Chadians has not blown up into a war between Chadian and Sudanese government forces, though Mr Déby has declared a "state of belligerence" with his eastern neighbour. The battle of Adré, he suggested, was nothing less than a Sudanese plot to replace his African regime with an Arab one. His Chadian army has concentrated its forces around Adré, exposing the southern bit of Chad's border with Sudan to banditry. Despite a peace agreement signed recently under international pressure in Libya, a nasty proxy war is in the offing, with Chad upping its support for rebels in Darfur, while Sudan backs the Chadian rebels camped in Darfur who still want to overthrow Mr Déby's regime.

Chad cannot afford any kind of war. It is a fragile and failing state with just a little oil. Since independence from France in 1960, it has had a series of ruthless military dictators; Mr Déby took power in a coup 16 years ago. Feuding between Chad's 200 or so tribes and clans is endemic. No government has ever managed to project its authority unopposed, in a largely desert country of 9m people five times the size of Britain with only a few

kilometres of surfaced road and porous borders all round.

Chad has become even shakier since 200,000 or so Sudanese have fled across the border from Darfur into eastern Chad in the past year or so. Another 45,000 refugees are in Chad's south, escaping violence in the Central African Republic. Western Chad, along the border with Niger, is a desolate wasteland. And the government bars visitors to the north, with its alluring Tibesti mountains, because of rebels and landmines. For many years Libya, claiming a slice of Chad known as the Aozou strip that was said to be rich in uranium, stirred up trouble in the north too.

Against such odds, Mr Déby has held the country loosely together—and survived. But that is about all. "It's not possible to speak of governance here," says a foreign resident. "There is *no* governance." Chad ranks near the bottom of just about every global league table. Transparency International, a Berlin-based anti-corruption lobby, judges it the most corrupt country in the world. Poverty is increasing as the population swells. Armed clashes over water and grazing are increasing.

The government often fails to pay salaries and pensions. Ndjamena, the capital, is expensive yet dilapidated. Colonial houses and the city's old cinema, La Normandie, are rotting away. Malaria is endemic, electricity sporadic even in the capital, and the sandy streets are oddly infested with orange-bellied lizards.

Mr Déby is kept in power largely by French support—and oil. Despite the possibility that he may one day be called to the International Criminal Court at The Hague to answer for past sins, the French hold their noses, arguing that Mr Déby, however despotic, remains the best bet for the country's development. President Jacques Chirac has given him his blessing. French garrisons in Ndjamena and Abéché help underpin Mr Déby's power.

Oil is his other helpmate. Recently increased production (to some 249,000 barrels a day) and the opening of a 1,070km-long pipeline from Doba in southern Chad through Cameroon to the Atlantic was specifically meant to alleviate poverty, thanks to a novel agreement between the World Bank and the Chadian government. The bank arranged the huge loans for building the pipeline (at a cost of $4 billion) and developing oilfields, only on condition that a fixed portion of revenue was set aside for poverty-tackling projects.

He doesn't like the strings

In flat contravention of that deal, Mr Déby now says he intends to spend the money as he pleases—mainly, in fact, on weapons and bribes to prop up his regime. In return, the World Bank has suspended its loans and blocked Chad's bank accounts. Mr Déby is railing against neo-colonialism—and has turned for help to Taiwan. The World Bank's leverage will weaken when the oil consortium, led by Esso, starts paying taxes next year, earlier than planned, thanks to the current high price of oil. That could bring in a useful early windfall of $100m: enough to keep Mr Déby's army going. He recently ordered a batch of helicopters from Ukraine.

To give him his due, Mr Déby needs his hardware. Since the Sudanese government is resisting the attempt by the UN to get a sufficiently well-armed force into Darfur to control the warring parties there, attacks from the Sudanese-backed rebels now encamped in Darfur are likely to continue. He also faces threats on several other fronts as well. His own Zaghawa people, who dominate Chad's government and straddle the border with Sudan, are widely opposed by Chadians from other regions. And there is resentment from sub-clans within the Zaghawa who feel they are getting too few of the presidential favours. But, though Mr Déby, at 53, is said to be in poor health, he shows no sign of wanting to bow out.

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United Nations peacekeeping

Quality strained

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Too few forces, too little oversight

AS THE insurgency in Sudan's Darfur region spills over into Chad, efforts to strengthen the beleaguered African Union force in the region, by turning it into a fully-fledged UN blue-helmet mission with twice as many troops (14,000) and a robust mandate, take on new urgency. Yet, according to the editor of a review of global peacekeeping by New York University's Centre on International Co-operation (CIC), without more support for the UN, a new mission in Darfur could take its peacekeeping efforts "past the point of overstretch".

That is bad news for sub-Saharan Africa. A study last year by the Liu Institute at Canada's University of British Columbia estimated that, while the number of armed conflicts around the world had dipped sharply since the early 1990s (perhaps due partly to an "explosion" of peacekeeping efforts by the UN and others), more people are being killed in African wars than in all the rest of the world.

According to the CIC, the number of troops deployed by the UN worldwide has nearly quintupled since 1999, from 12,700 to over 60,000 (with civilians and police, the number is over 85,000). But the system is now under acute and worsening strain: requests to add to UN forces in Congo and Côte d'Ivoire were rejected. The CIC report calls for "strategic reserves" to be developed, so that troops can be sent more quickly to trouble spots and missions under strain can be reinforced faster. Yet, as the UN struggles, numbers of peacekeepers deployed by organisations such as NATO, the European Union and the African Union have more than halved since 1999, from 108,000 to 50,000 (and even then NATO has been having all kinds of problems scraping together enough troops for its force in Afghanistan).

At the UN itself, getting more boots on the ground isn't the only problem. The undersecretary-general for peacekeeping, Jean-Marie Guéhenno, likes to call his blue-helmet fief "the leanest field operations organisation in the world"; its missions cost $5 billion in 2005, according to the CIC report. Yet managing increasingly large and often hybrid operations involving other partners is increasingly tricky. In 1998, the UN's largest mission, in Lebanon, involved 4,500 personnel. This year, it will have five missions of this size and larger.

As the strain tells, the flaws get wrenchingly apparent. Prodded by America, last week the UN Security Council took a hard look at both waste and fraud in peacekeeping procurement and also at reports of sexual abuse by peacekeepers of those they are sent to protect. After investigations started two years ago into reports of such abuse in Congo and west Africa, 137 military people (including six senior ones) and 17 civilians have been dismissed or sent home. Other cases are still under investigation. UN officials blame such problems on a "culture of dismissiveness" among their own staff, in countries providing troops and in the missions themselves. Their strategy for dealing with it is to be published this month.

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Uganda

Democracy or dictatorship?

Mar 2nd 2006 | KAMPALA AND JINJA
From The Economist print edition

The re-election of Yoweri Museveni may spell trouble

THE incumbent cantered home in Uganda's presidential election, on February 23rd, with an official tally of 59% of the vote. Yoweri Museveni's closest and bitterest rival, Kizza Besigye, got 37%. The president's National Resistance Movement also retained its majority in parliament. So Mr Museveni, who took power after a civil war in 1986, has another five years in office. What this means for Uganda depends on whether Mr Museveni takes a nosedive into dictatorship.

It is a worry. Mr Museveni already operates the politics of patronage, with family and friends' businesses benefiting from access to the president and first lady. He has taken to railing against meddling foreigners, even though their aid pays half of his government's budget. And though voting day passed off fairly peacefully, the months leading up to it were rough. Mr Besigye was dragged through court to answer a variety of charges, including rape and treason. Mr Museveni used state funds to shore up his base, and is now stirring up fears that opposition supporters want to burn down buildings in Kampala, the capital, and have been meeting with terrorists.

Mr Museveni may now use his mandate to crush the opposition. That would anger donors, but he is convinced, perhaps rightly, that countries such as Britain, the United States, Ireland and Norway, which give the most, have invested too much political capital in Uganda to pull out. It was the donors, after all, who burnished Mr Museveni's reputation, citing his still impressive record of economic stability and initial success in tackling HIV/AIDS.

But even if he chooses to be conciliatory, it is not clear that Mr Museveni can develop or unify the country. The results revealed deep divisions. Mr Museveni's strong showing in the west, his home turf, probably means more state money and jobs heading that way, at the expense of the north and east, which leaned more towards Mr Besigye.

A country divided

In the north at least 1.5m people live in squalid refugee camps for fear of the Lord's Resistance Army, an unusually cruel rebel group. The camps have worsened even as Mr Museveni has bragged of pushing the rebels into neighbouring Congo. With international arrest warrants hanging over them, the rebel leaders have little incentive to negotiate, so peace, under Mr Museveni, looks unlikely soon.

His other test is to boost the economy in the neglected east. Jinja, where Lake Victoria pours into the Nile, is a favoured tourist spot but was once also a thriving town, refining sugar cane, canning fish and spinning cotton. Its prosperity was built up by Uganda's Asians, so the town went into a sharp decline in the 1970s after President Idi Amin expelled them from the country. Today its art-deco buildings in the main street are still run down, its factories shut and its inhabitants short of work. Its two dams are meant to supply cheap electricity to Uganda but the town, like the rest of the country, gets only sporadic power, ruining the few surviving enterprises.

Yet the villages around Jinja voted for Mr Museveni. Unlike the northerners, they thank him for bringing security: no mean feat, given Uganda's post-colonial history. Under Amin's rule, the Jinja dams' turbines sometimes choked with the bodies of his victims, drifting in from the lake.

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South Africa

A little local trouble

Mar 2nd 2006 | JOHANNESBURG
From The Economist print edition

Many people are revolting against the ruling party over a lack of services

Get article background

Reuters

The poor want more from their president

IN THE settlement of Thulamntwana, only 40km (25 miles) south of central Johannesburg, the dirt road in front of the polling station had turned into a river after heavy rain. Voting in this week's local government election was slow, the atmosphere sour. The people who live here were relocated from the city a decade ago, and promised houses and amenities they are still waiting for. Instead, they share communal portable toilets, and lack running water and electricity. They feel forgotten and ignored, their feelings inflamed by their treatment at the hands of the local ruling African National Congress (ANC) in the run-up to the election. They complain they were not consulted at all in the selection of the new ANC candidate, who does not even live in the settlement.

The experience of Thulamntwana has become increasingly common across South Africa, and national disenchantment with the ANC over the poor delivery of basic services has risen. Early results suggested that the ANC might get a bit less than the 70% of the vote it won at the last general election; in any event, its leaders will be given pause for thought. Over the past year, there have been many protests, occasionally violent, against the continuing lack of running water, electricity and proper toilets.

Ahead of the poll, the ANC, under President Thabo Mbeki, had been promising a lot—an end to bucket toilets by next year, clean water for all by 2010 and electricity to every house by 2012—but will struggle to honour its pledges on the ground. Over the past decade, the ANC can claim to have built 1.6m houses and brought clean water to an additional 9m people. Still, more than half the municipalities do not provide sanitation, clean water or rubbish collection to over 40% of their households; over 2m families (there are reckoned to be 13m households in a population of 47m) still live in shacks with no running water. Twelve years after the ANC first came to power, patience is wearing thin among the poorer black voters, most of whom always supported the party.

In 2000, over 1,200 once racially segregated local administrations were melded into 284 local and district municipalities, which were given broad responsibilities. Most have struggled to cope. The main problem is not lack of money but a crippling shortage of skilled staff. In the Eastern Cape, the O R Tambo district, which embraces 1.7m people, plans to spend 900m rand ($146m) on water and sanitation in the next three years but does not have a single qualified engineer on its staff. Whereas there were between 3,500 and 4,500 engineers in local government ten years ago, there are now only 1,500.

Send them help

The government is trying to help. In 2004, it launched Project Consolidate to help municipalities in trouble by sending them managers from comparatively well-run cities. So far, though, only 25 out of the 136 that need help have received it under the initiative, which is due to end next year. And the Development Bank of Southern Africa, a government outfit, is busy recruiting engineers, project managers and other specialists to be seconded full-time to struggling municipalities.

However, given the size of the problem, that is unlikely to be enough. There are other headaches too. Appointments have often been made as a reward for political loyalty rather than competence. Opposition parties accuse the ANC of being soft on corruption. They point to candidates such as Ruth Bhengu, a former ANC MP convicted of fraud, who was happily running this week for office in KwaZulu Natal.

One promising initiative was the creation, in 1998, of the Municipal Infrastructure Investment Unit, which has helped municipalities to contract private companies to build and run things like sewage plants or to manage their

accounts. This has gone well, but there are few such arrangements. Until municipalities can harness the private sector better, they are likely to remain short on skills—and their residents short on toilets.

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France

The art of crisis management

Mar 2nd 2006 | PARIS
From The Economist print edition

A swashbuckling prime minister has to fight on many fronts at once

Get article background

DOMINIQUE DE VILLEPIN knows a thing or two about crisis management. He was President Jacques Chirac's first chief of staff in 1995, which proved a baptism of fire when France promptly restarted nuclear testing in the south Pacific. Two years later, he advised the president to dissolve parliament in the face of huge street protests, only to see the centre-right lose its parliamentary majority to the Socialists. And in 2003 he was foreign minister when France was vilified in America for its active opposition to the war in Iraq. But even this hardened political fire-fighter, who is now Mr Chirac's prime minister, must be finding the latest outbreaks quite a challenge.

Over the past few weeks, Mr de Villepin has rushed from one drama to the next. No sooner had he dealt with the fallout from Mr Chirac's humiliating decision last month to call home the *Clemenceau*, a decommissioned, asbestos-laden aircraft-carrier that had been sent to India for scrap, than panic about bird flu broke out in France. Since the discovery of a dead duck carrying the H5N1 virus near Lyons, the disease has spread to a poultry farm, for the first time in Europe. To the indignation of France's vocal farmers, 43 countries have now banned French imports of poultry and *foie gras*.

Since then, disasters have multiplied. An epidemic of a mosquito-borne disease, chikungunya, has struck the French island of Réunion and led to 77 deaths. Fears of a new wave of anti-Semitism were unleashed after the grotesque kidnap, torture and murder of a Jewish man by a gang in a Paris suburb. Even the merger of two French energy companies announced last weekend by the prime minister, followed by this week's anti-foreign-takeover plans, seemed to be put together in panic (see article). The picture is of a government on the defensive, improvising reactions to events. Mr de Villepin's popularity slumped during February by 11 points, according to a CSA poll, to a lowly 36%.

Plainly, these events are unconnected in any sense other than the political trouble they present. Only two might be called blunders. The return of the *Clemenceau* was a victory for green activists, who had accused France of exporting toxic waste to the third world. Not true, the government replied: it was not sending "waste" to India, but "war equipment", and so could legally do so even though large amounts of asbestos still had to be stripped out. It was only when the Conseil d'Etat, France's highest administrative court, ruled in February that the hulk was in fact "waste", that Mr Chirac, on the eve of an official visit to India, ordered the ship home.

The chikungunya outbreak also appears to have involved political neglect. Last year, despite a rapidly rising number of cases, the National Institute of Health Surveillance declared that the disease was "not a worrying phenomenon" for public health. As recently as January, Xavier Bertrand, the health minister, described it as "not fatal". Not until last weekend did Mr de Villepin fly off to the island, announcing €76m ($90m) in aid. The

government, said François Hollande, the Socialist leader, had shown "intolerable indifference" to the epidemic.

But even the other events reinforce the impression of a government caught off guard. In the case of the energy merger, the underlying principle is unsurprising. Mr de Villepin has made "economic patriotism" his mantra, denouncing hostile takeovers by foreigners at every turn. The difference in the latest case, a merger of Gaz de France and Suez, is the perception of indecent haste. Mr de Villepin approved the deal only after it became clear that Suez was vulnerable to a hostile Italian bid, holding a press conference on a Saturday to make the surprise announcement. Since the deal means going back on a promise not to privatise Gaz de France, the unions see it as a ploy to sell the utility by stealth: a strike has been called next week.

In the case of the abduction and murder of Ilan Halimi, there was frustration among French Jews that it took so much time to recognise its anti-Semitic nature (see article). The public prosecutor initially said that there were no grounds to suspect anti-Semitism. The government, Halimi's uncle told *Haaretz*, an Israeli newspaper, was "afraid of reigniting confrontation with the Muslims." It was Nicolas Sarkozy, the interior minister, who first used the term "anti-Semitism", in parliament. Days later, after pressure for a gesture of solidarity, Mr Chirac and Mr de Villepin were at a memorial service for Halimi in Paris's main synagogue.

The last thing Mr de Villepin needed was the bird-flu scare. But might it provide an opportunity to counter the impression of ill-preparedness? He had, after all, put an emergency ministerial team in place, and ordered vaccinations, before the disease actually arrived. A simulation of a human infection was organised in Lyons. This week, with European Union approval, France began vaccinating geese and ducks in the south-west. During a five-hour visit to the (birdless) Paris agricultural show, Mr de Villepin tucked into as much chicken as he could lay his hands on.

Sometimes, a well-managed crisis can boost a politician's standing—or perhaps provide cover for other unpalatable policies. It cannot harm Mr de Villepin that France's health scares have been grabbing headlines at a time when he is trying to push through parliament a more flexible—but hugely unpopular—new employment contract for those under 26. Resistance to this is fierce, and may account for much of the recent drop in his popularity. A rise in unemployment in January, to 9.6%, the first increase since the prime minister took over last May, has not helped. Next week mass student protests will be staged against the contract.

The trouble is that health scares tend to affect political popularity only when they go wrong. "A badly managed health crisis can destroy a politician, but nobody thanks one for a catastrophe that doesn't happen," says Dominique Reynié, a political scientist at the Sciences-Po university in Paris. Jean-Pierre Raffarin, the previous prime minister, never recovered his credibility after thousands died while ministers were on holiday during a heatwave in the summer of 2003. Worse, under the fifth republic, prime ministers have consistently suffered from what is known as the *malédiction de matignon*. Once confidence in the polls has been lost, no prime minister has fully recovered—and none has gone on directly to win the presidency.

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Anti-Semitism in France

The terrible tale of Ilan Halimi

Mar 2nd 2006 | PARIS
From The Economist print edition

A horrific murder triggers new fears over anti-Semitism

AP

Five flags over Paris

HE WAS bound and left to die close to a suburban railway station outside Paris. He had been kidnapped and brutally tortured for three weeks by a gang demanding a ransom from his family. His naked body was covered in bruises, knife slashes and burns. The presumed gang leader, Youssouf Fofana, who calls himself "the brain of the barbarians", now faces extradition from Côte d'Ivoire, where he fled. Those responsible for the murder of Ilan Halimi, said Nicolas Sarkozy, the French interior minister, last week, acted on the belief that "Jews have money. That is called anti-Semitism by amalgam."

France has been rocked by the murder of this young mobile-phone salesman from a modest family. Last weekend, politicians of all stripes—from Mr Sarkozy on the right to François Hollande, the Socialist leader, on the left—joined tens of thousands in a march against racism and anti-Semitism. The murder seemed to some a grotesque fusion of many of France's current troubles: violence, immigration, the *banlieues*, nihilism, racism, anti-Semitism. The discovery of this degree of inhumanity, perpetrated by French-educated youths, of both immigrant and white French descent, and including Islamist extremists, has taken the country aback. It was, as *Le Monde* put it, "a crime of the times, a form of magnifying glass on the real state of our society."

It is not just the ugly nature of the murder that has stirred tempers. France is particularly sensitive to charges that it is anti-Semitic, especially since Ariel Sharon called in 2004 for French Jews to migrate to Israel because of "the wildest anti-Semitism" in their country. In a poll in February, 57% of those questioned said they thought that anti-Semitism was on the rise. In fact the latest police figures suggest that the number of anti-Semitic attacks in 2005 fell by nearly half compared with 2004, from 974 to 504.

The government knows it is in the international spotlight, and can afford no complacency. In the past, this has sometimes led to over-hasty claims of anti-Semitism. Shortly after Mr Sharon's appeal, when Dominique de Villepin, the prime minister, was interior minister, he denounced an apparent anti-Semitic attack against a young woman on a train, which later turned out to have been fabricated. This may explain why, in the Halimi case, the government waited before accepting its anti-Semitic nature.

France is treading a delicate line between the need to be seen clamping down on anti-Semitism, and a wish not to stir up sectarian and religious hatred. The country is home not only to Europe's biggest Jewish population, but its biggest Muslim one too. Religion was not a big factor in last autumn's suburban riots. But they showed the potential for violence in the *banlieues*, home to so many of France's Muslims.

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Russia and central Europe

Pretty pictures

Mar 2nd 2006 | BUDAPEST, PRAGUE AND WARSAW
From The Economist print edition

Russia's president makes some surprising new friends

Get article background

EPA

Putin bows to history

VLADIMIR PUTIN has rarely paid much attention to the sensitivities of former Soviet satellites. Requests to return property looted during the war usually meet studied indifference. Any demand for an apology for Soviet-era crimes prompts a brusque restatement of history as seen from the Kremlin, along the lines of "we freed you from Nazism: be grateful."

But in a trip this week the Russian president has tried a more emollient approach. In Budapest, he laid a wreath to commemorate victims of the 1956 Hungarian uprising, crushed by Soviet tanks. He declared that "Russia is not the Soviet Union, but, I have to tell you frankly, we all feel some kind of moral responsibility for these events in our souls." He also handed back a valuable library of old books and manuscripts, looted by Soviet soldiers from a Protestant seminary in 1945.

Such unprecedented words and deeds mark a new level of reconciliation between erstwhile captor and captive, albeit with a twist. For its part, Hungary had soothed Russian opinion by apologising for siding with the Nazis during the second world war. It also paid more than $400,000 in "storage charges" to the provincial Russian library that had held the books. Cynics note that other war booty, including dozens of valuable paintings once owned by rich Jewish families, remain in Russia with no prospect of return.

Later in the week, in Prague, Mr Putin met one of his warmest admirers abroad: Vaclav Klaus, the Czech president. Mr Klaus said there was no need to discuss the Soviet-led invasion of 1968; Mr Putin acknowledged Russia's "moral responsibility". The Czechs are also returning to Russia a painting by the artist Ivan Kramskoi, which was looted by the Nazis and ended up in an art gallery in Brno. Protests against the war in Chechnya and creeping dictatorship throughout Russia by Mr Klaus's predecessor, Vaclav Havel, and by opposition politicians have made little impact.

Russian officials are praising the "pragmatic" approach of the Czechs and Hungarians, in which historical grudges are sidelined and trade ties are promoted instead. Relations with most other post-communist countries in the European Union, by contrast, have been chilly. But a senior government source in Warsaw says that even Poland is noticing tentative signs of warmth. In January, Mr Putin sent a telegram of condolence after a building collapsed in Katowice, killing 65 people. He also gave an unexpected and effusive interview about the two countries' common interests to Polish television.

What is up? To some extent Mr Putin may simply be trying to repair the damage done to Russia's reputation by the clumsy wobbles over gas supplies at the start of the year. These accelerated the search for alternative sources of energy in countries that are still largely dependent on Russian gas. But some clever diplomacy may be at work too. The charm offensive could be aimed at isolating Estonia and Latvia, the countries in the EU that have the worst relations with Russia. These two particularly want the Russians to ratify treaties that recognise their post-war borders.

Both treaties were kyboshed last year, when Estonia and Latvia chose to issue declarations underlining their status as occupied territories during the Soviet era. Russia contests that view, insisting that the Baltics joined the Soviet Union legally. Because of this, and thanks to the caustic way in which the Russian media cover them, the Baltics still see Russia as scary. Most west European countries, however, think they are being neurotic, and should shut up about the past. That view may be strengthened by Mr Putin's surprisingly friendly visit to central Europe.

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Montenegro's independence

State-building

Mar 2nd 2006 | PODGORICA
From The Economist print edition

The European Union endorses hurdles for an independence vote

Get article background

LAKE SKADAR, straddling the border between Albania and Montenegro, is one of the most beautiful spots in the Balkans. Tiny, mysterious islands rise from its blue-green waters. Drive from Albania along the lake and you see something else: a country returning from the mists of time. At the frontier the flag of Montenegro flaps lazily in the wind. Travellers are checked by Montenegrin police and customs officers. Nothing odd here—except that their country does not exist. If the Montenegrin government gets its way, it soon will.

Technically Montenegro is part of a loose federal "state union" with Serbia, whose 8m people dwarf Montenegro's 673,000. Throughout the Balkan wars of the 1990s Montenegro stood by Serbia. But since 1997 various governments led by Milo Djukanovic have been hoping to restore the independence that the country lost to the old Yugoslavia in 1918.

Unlike public opinion in neighbouring Kosovo, however, support for independence is far from wholehearted, suggest the polls. If pro-union parties boycott the referendum on independence, now set for May 21st, a crisis could ensue. Hence a plan proposed by Miroslav Lajcak, the Slovak special envoy for the European Union. He has suggested that any referendum must be endorsed by 55% of those voting; and that, to be valid, at least 50% of the electorate must take part. The EU's foreign ministers have backed Mr Lajcak's proposal.

Polls suggest that independence is supported by around 41% of Montenegrins and opposed by 32%. Since Mr Lajcak's plan first became public, Montenegrins have become keen mathematicians. The referendum may produce a slim majority for independence, but much will depend on turnout. Yet if the vote in favour is just 54.9%, says Dragan Koprivica, spokesman for the pro-union Socialist People's Party, the government "would not have the right to promote an independent country."

Pro-independence politicians are seething about the Lajcak plan. They say it is undemocratic, since it means that a pro-union vote is worth more than a pro-independence one. Montenegrin officials also complain that they were blackmailed by the EU, which insisted that, unless they accepted the Lajcak plan, itwould not allow monitoring of the referendum by the Organisation for Security and Co-operation in Europe, undermining the vote.

Miodrag Vlahovic, Montenengro's foreign minister, declares that, if there is even a one-vote majority in favour of independence, "it is absolutely clear, the state union will not exist any more." The implication is that Montenegrins who participate in joint institutions with Serbia, such as the army and the foreign ministry, would be recalled. Mr Koprivica says that his party activists report that Mr Djukanovic's people are offering €150 ($180) bribes to secure votes. But the pro-union party has an uphill struggle of its own: its members are mostly old and its leaders are linked to the ugly face of Serbian nationalism.

Pro-independence supporters joke that officials from Brussels act as though they work "for the Soviet Union not the European Union". Mr Vlahovic insists that "who will win in Montenegro will be decided in Montenegro, and not in Brussels." He seems confident of victory. Mr Djukanovic's supporters believe they can win a 57% majority for independence; some sources add that the party is keeping this quiet because, with a tight battle ahead, it does not want to foster complacency.

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Iceland and Europe

Euro dreams

Mar 2nd 2006
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The prime minister starts a debate about joining the European Union

IT IS remote and tiny, with just 300,000 people. Yet Iceland's recent performance is impressive by any standards. One of Europe's richest countries boasts one of its fastest-growing economies. Top marginal rates of income and corporate tax have been cut to unNordic levels of around 36% and 18%, respectively. Unemployment is in effect near zero. And the economy has diversified far beyond fish to such areas as banking and telecoms. Icelandic investors have also forayed abroad: the prime minister, Halldor Asgrimsson, says that they now employ over 100,000 people in other countries, 70% of them in Britain.

Yet over the past two weeks severe financial tremors have jolted Iceland. A rating-agency downgrade, prompted by worries over rising inflation and a whopping current-account deficit of as much as 15% of GDP, triggered a sharp sell-off of the Icelandic krona, which briefly hit a new low against the dollar. Interest rates had already doubled in the past two years, to over 10%. There are widespread fears of a crash in Reykjavik's dizzy house prices.

In an interview during his recent visit to London, the first paid by an Icelandic prime minister since the 1970s cod war, Mr Asgrimsson seemed unruffled. He took over in late 2004 from the long-serving David Oddsson, who is now the central-bank governor. The shift was not just from Mr Oddsson's Independence Party to Mr Asgrimsson's Progressive Party; it was also from Mr Oddsson's staunch Euroscepticism towards Mr Asgrimsson's cautious openness towards the European Union.

Last month, Mr Asgrimsson created a stir by predicting that Iceland would be a member of the EU by 2015. He points out that Iceland is in almost every other international club around, including the European Economic Area, which means that it already has to abide by most Brussels directives. He adds that developments in Britain, Sweden and Denmark will count for much: if these three were to join the euro, for example, 70% of Iceland's imports and exports would be in euros.

Even so, the path towards putative EU membership remains highly uncertain. Icelandic business is mostly in favour, but the foreign minister, Geir Haarde, who now leads the Independence Party, is against—and, with an election next year, he is far higher in the polls than Mr Asgrimsson. Fish will always be a problem: as a former fisheries minister himself, Mr Asgrimsson asserts that Iceland has managed its stocks much better than the EU has done, and it is not about to give up control. That might be hard for the EU to swallow.

Public opinion is also fickle, though for most of the past three years opinion polls have shown a narrow majority in favour of joining. Mr Asgrimsson insists that Iceland will not make the same mistake as Norway, which has held and lost two referendums on membership. What he hopes for is a proper long-term debate about the EU, which would lead to membership only if there were strong public support and a cross-party consensus.

The biggest argument for joining, put by both Mr Asgrimsson and many Icelandic businessmen, is not a sudden love for Brussels but a simple desire for currency stability. If Iceland could join only the euro, but not the EU, all might be happy—and it would create one more version of the multi-tier, multi-speed Europe that is anyway emerging.

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Ireland, north and south

March off

Mar 2nd 2006 | DUBLIN
From The Economist print edition

Parade trouble moves south of the border

Reuters

When Irish eyes stop smiling

COULD 300 loyalists from Northern Ireland march down O'Connell Street in Dublin, right past the General Post Office, where Ireland's rebellion against British rule began at Easter 1916? The answer, it seems, is no. Or so the loyalists who tried to do just that discovered last weekend, when they met republican dissidents blocking their path in a counter-protest.

The counter-protest swiftly degenerated into the biggest riot the city has seen for 25 years, forcing the cancellation of the loyalist parade. For several hours gangs of disaffected youths and a few drunken thugs attacked the police, wrecking cars and looting shops in acts of indiscriminate violence reminiscent of last year's riots in French suburbs.

The cost of the riot was put at some €10m ($12m). But the damage to national self-esteem has been far greater. The planned loyalist march in Dublin was a test of Ireland's tolerance as a modern pluralist society, and its acceptance of an alternative unionist tradition. The Northern Irish protesters, most of whom were relatives of victims murdered by the IRA, were exercising the rights to free speech and free assembly that are guaranteed by the Irish constitution. They failed to secure those rights when the police failed to uphold them along the agreed route of the march.

The security authorities seem seriously to have underestimated the task of ensuring the safe passage of the loyalists down O'Connell Street, which besides being the focal point of the Easter rising is also Dublin's high street. As the Tanaiste (deputy prime minister), Mary Harney, conceded, the riots had brought "shame on the city, shame on the country". They have also added new strains to relations between north and south, as the efforts of both the Irish and British governments to restore a devolved government in Belfast falter, thanks in large part to the obduracy of the Rev Ian Paisley, leader of Ulster's Democratic Unionist Party.

Last year, the president of Ireland, Mary McAleese, a northern nationalist, was forced to apologise for asserting that some Protestants in Northern Ireland had raised their children to hate Catholics in much the same way that Nazis had hated Jews. Mr Paisley claims to find her dishonest. He also resents her frequent visits to Northern Ireland, chiefly devoted to bridge-building exercises between the two communities.

If loyalists cannot march down O'Connell Street in safety, a state visit by the British monarch, which had been under active preparation, suddenly seems less likely to take place as well. Indeed, the republican-inspired mob may have had precisely this in mind when they took to the streets.

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Charlemagne

The nationalist resurgence

Mar 2nd 2006
From The Economist print edition

Why the forces of economic nationalism seem weaker than those of globalisation

THE merger will liberalise share ownership and create one of the biggest companies in the world, said the minister. "I have a vision of transforming it into a vast, diversified energy giant encompassing not just gas but oil and electricity." Oh, sorry, that was not Dominique de Villepin, France's prime minister, announcing that the marriage had been arranged and would take place between Gaz de France and Suez, two big French energy firms. It was Alexei Miller, boss of Gazprom, describing his company's takeover of a Russian state-owned oil firm last year.

There are indeed some uncomfortable similarities between the European Union's mood just now and Russia's state-directed capitalism. The French government seems to favour a sort of Gallic Gazprom, that well-connected and politically influential behemoth. France, Italy and Luxembourg have little lists of national champions they think should be immune from foreign ownership. The Spanish government prefers a home-grown energy champion to seeing a local firm fall into the hands of a German utility. And so on (see article).

Behind this lurks the explicit view that the nationality of ownership matters; and the implicit one that foreign firms could become agents of foreign governments (a suspicion for which there is almost no empirical evidence). Thus the merger of two French or two Spanish energy firms is acceptable, but a takeover of a French or Spanish firm by a German one is not.

Whether or not this contradicts the law of the European single market, it certainly contradicts the spirit of the European Union, as several commissioners have been pointing out. The EU embodies the notion that countries are better off when they share sovereignty and that, in certain areas—the single market pre-eminent among them—nationality should not matter. Arguably, that would be true even if the EU did not exist: in a world of global capital, ownership becomes diffuse and fuzzy in any case. But the EU does exist; and that makes the notion of defending national champions against European partners as quixotic as saying that a yogurt-maker is a strategic asset in the first place.

Yet official behaviour is only part of this story, and perhaps it is the less important part. Today's hysteria about cross-border mergers is in some ways the opposite of what happened 25 years ago. In the 1980s, the impetus behind the creation of the single market came from liberalising governments; most of the opposition came from companies fearful of being exposed to more competition. Now, argues Ernest-Antoine Seillière, head of UNICE, the European employers' association, opposition to liberalisation comes mainly from governments and unions, while the impetus for change comes from companies.

Europe is experiencing a wave of mergers, the largest since the dotcom boom of 2000. Unlike previous waves, this one is not just national; it floods across borders. In 2005 the value of cross-border mergers in the EU was the highest since 1999-2000; in the first two months of this year, cross-border deals have for the first time ever accounted for over half of all European mergers by value. Mergers can be wise or foolish, competitive or anti-competitive, of course. But at least they are usually business decisions, not political ones. They have more to do with corporate restructuring and the single market than with the creation of European or national champions.

So while it is true that Europe is flirting with economic nationalism, it is not the whole truth. It would be more accurate to say that, as in Russia, a battle is engaged between two opposing forces: protectionism and economic nationalism on one side, business restructuring and globalisation on the other. The two inevitably clash. The protectionist instinct is growing and could get stronger: France's anti-competitive actions are provoking other countries to retaliate, risking a downward spiral. But in general the market-opening activities of companies look more powerful than the market-closing instincts of governments.

Opening up

This is partly because those market-closing instincts are neither uniform nor all that strong. Despite backsliding on trade (most recently a curious attempt to defend Europe's downtrodden shoemakers against competition from that economic powerhouse, Vietnam), the European Commission is relatively liberal—if only because most of its authority comes from policing the single market. Economic nationalists reside in national capitals, as you would expect. And even there, protectionism is a squib, not a constant ray. Governments are in theory committed to market liberalisation and they know that autarkic nationalism would be toxic: they swallow it in small doses out of short-term political expediency or to curry favour with unions.

In contrast, the forces driving companies to go global are relentless and all-embracing. Across Europe, the past few lean years have forced companies to cut costs, restructure their balance sheets, reduce debt and boost profits. Interest rates are still low, adding to the attractions of mergers financed by debt. These pressures will not ease. The need for capital and new markets is pushing companies across borders faster than governments can put up obstacles to them.

In other words, companies will take advantage of the single market wherever they can. The question is whether governments can impede them. The recent case of Germany is instructive. In the face of high wages, inflexible labour laws and declining competitiveness, the German government's efforts at reform were fitful and half-hearted. But German companies restructured, cut costs, reorganised and laid off workers. Competitiveness and business confidence have rebounded. But the cost of relying on companies alone to reform is persistently high unemployment. The moral is that Europe's nationalists cannot reverse or perhaps even much affect the market-opening actions of their companies. But they may increase its cost.

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Women's pay

The hand that rocks the cradle

Mar 2nd 2006
From The Economist print edition

Why women are still earning less than men

Birthing pains
Average hourly female wage as a % of average male wage, all workers
95
90
85
80
75
70
65
60
-5 -3 -1 1 3 5 7 9 11 13 15 17 19 21 23 25 27 29
Years until or since birth of first child
Source: Department for Work and Pensions

WHATEVER the truth of the aphorism that a mother's place is in the wrong, it seems that working mothers, at least, are in the wrong place. Or so concludes the Women and Work Commission (WWC), whose long-awaited report on the causes of the "gender pay gap", the difference between men's and women's hourly earnings, was published on February 27th. The commission found that the pay gap (British women in full-time work currently earn 17% less per hour than men) was due not so much to a pattern of paying women less than men for doing the same job as to something far harder to root out. Women are making the wrong choices early in their careers and sliding into dead-end part-time jobs after they have children, with serious consequences for their lifetime earnings.

A few days earlier, the European Commission brought out its own report on the pay gap across the whole European Union. Its findings were similar: per hour, European women earn 15% less than men. In America, the difference in median weekly pay is around 20%.

According to the WWC, the gender pay gap opens early. Boys and girls study different subjects in school, and boys' subjects lead to more lucrative careers. They then take different degrees and work in different sorts of jobs. As a result, average hourly pay for a woman at the start of her working life is only 91% of a man's, even though nowadays she is probably better qualified.

The gap widens to a chasm during women's working lives, for a fundamental biological reason: motherhood. According to the Institute for Fiscal Studies (IFS), a research outfit, the hourly pay of women with children relative to that of men with children falls to 67%. And the Institute for Public Policy Research, another think-tank, recently calculated that a woman with middling skills who has a baby at age 24 loses £564,000 ($981,000) in lifetime earnings compared with one who remains childless. (The figure is lower, although still substantial, if she waits a while.)

The Labour government sees affordable child care as crucial to narrowing the pay gap. The Conservatives are following suit, trying to re-position themselves as modern and woman-friendly. In a speech on February 27th, George Osborne, the shadow chancellor, hinted that his party would subsidise a wider range of childcare options than the government does currently. He went on to say that it should not be the business of the state whether women choose to work or stay at home with their children.

He is right. But most British women do not want to work full-time and park their babies in nursery care all day, as mothers in some countries do. They would prefer to work part-time while their children are young, and perhaps have their partners do likewise. (Around two-thirds of British women with children under 11 work part-time.) Often, though, they cannot do this in their current jobs, but must move to a lower-paid, lower-skilled job, or leave the workforce altogether.

Too often this move to the "mummy track" is irreversible. According to the IFS, women's hourly pay recovers only slightly by the time their children leave home, when it is 72% of men's pay, and although their employment rate increases steadily as their children grow up, it never returns to the same level as men's.

One could argue that people should not be protected from the consequences of their own choices. But female workers are needed to pick up the demographic slack as society ages, and low pay will make work seem less appealing to them. Rising divorce rates mean that women—and their children—are having to rely more on women's earnings, or on the state. Low pay for women increases poverty among children and costs taxpayers money. Families where both partners work are less vulnerable to sudden shocks. Ceri Peach, a professor of social geography at Oxford University, has examined employment and other characteristics of British Muslims and come to the conclusion that their socio-economic marginalisation is largely down to low rates of female employment.

There is also good evidence that not all the errors women make are unforced. The Women and Work Commissioners declared themselves shocked by the careers advice and work experience on offer in British schools. Girls were often allowed to give up maths and science without any warning about the consequences for their future earnings. They were offered work experience in nurseries and hairdressers—even when they had expressed no interest in working in these fields. And careers advisers often didn't even mention pay levels in different jobs. So the proposals to improve subject choices, careers advice and work experience make a lot of sense.

Other suggestions are rather less to the point. Some are mere exhortations ("Employers should ensure that their managers, at all levels, are regularly and continually trained on diversity and flexibility issues"), and some are comical ("The Department for Culture, Media and Sport should set up two high-level groups, of advertisers and key players in television drama, to encourage non-stereotypical portrayals of women and men at work"). They do, however, make the crucial point that the pay gap will never close unless it becomes easier for women to go part-time while staying in the same job.

Since 2003, companies have had to give serious consideration to employees (female and male) with children under six who request flexible working hours. Many employees have taken up this "right to request": nearly one in five working women and one in ten men. It is still too early to tell whether the new law is making a difference to working patterns, but there is clearly the potential for a change. Without it, Stendhal's lament will continue to have resonance: that geniuses born as women are lost to the public good.

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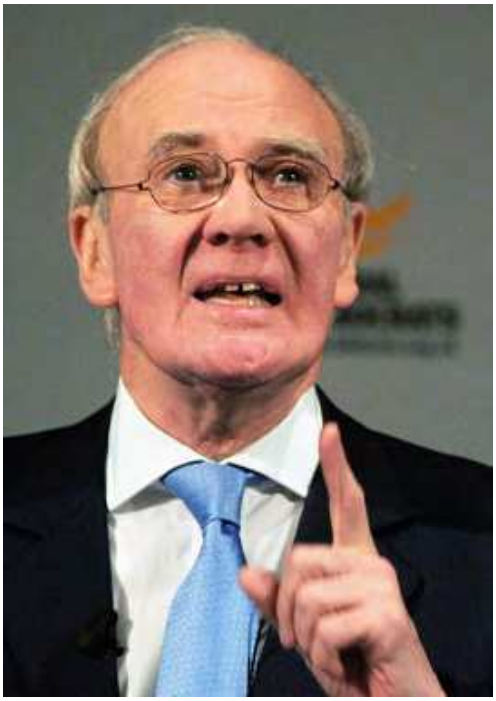
Liberal Democrats

A safe pair of hands

Mar 2nd 2006
From The Economist print edition

Sir Menzies Campbell, the Lib Dems' new leader, is a vote for continuity

Getty Images



And now take charge

THIRD parties with little prospect of forming a government are rarely the stuff of media frenzy. The Liberal Democrats are different. They have, of course, produced a steady supply of scandalous scuttlebutt, including an alcoholic leader, who was forced to resign in January, and two leadership candidates of ambiguous sexual orientation. More importantly, they may well hold the balance of power in the next Parliament.

So the election of Sir Menzies "Ming" Campbell as leader of the Liberal Democrats, announced on March 2nd, matters. Sir Ming is, above all, reassuring, especially to a party badly rattled by recent revelations about other party notables. A somewhat elderly 64, he has a patrician air and at least looks the part of a potential prime minister in a way that his predecessor, Charles Kennedy, never quite did. What more does he offer?

Sir Ming spent years as his party's spokesman on foreign affairs, and this remains his strength. It is also his party's: the Lib Dems' opposition to the Iraq war was one reason why they did so well in the general election last May. On domestic policy issues his knowledge is minimal, and the results suggest that rank-and-file Lib Dems were not wholly convinced. Yet Chris Huhne, Sir Ming's most threatening rival, has been in Parliament for only ten months and many thought his bid presumptuous.

Sir Ming will need to steer carefully a party divided between modernisers keen to bring fresh rigour to policy-making and more left-wing traditionalists. Chances are that he will be firmly on the side of the modernisers, most of whom gave him their backing. He will also lean on the party's Treasury spokesman, Vince Cable, who sacrificed his own leadership ambitions to Sir Ming's.

As things stand, the party is in surprisingly good shape. It weathered the turmoil of early January and recovered its standing in the polls after a spectacular by-election victory in Scotland. But they face a threat from the Tories under their new leader, David Cameron, that is unlike anything they have experienced.

This week, Mr Cameron published a statement of "aims and values" for what he calls a "modern, compassionate Conservative Party", inviting party members to vote on it. Largely policy-free, the statement does include such unTory-like sentiments as "the right test for our policies is how they will help the most disadvantaged in society, not the rich" and "it is our moral obligation to make poverty history". In Mr Huhne, Sir Ming has beaten off one young whippersnapper. Now he must take on another.

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Political sleaze

Tess of the Virgin Isles

Mar 2nd 2006
From The Economist print edition

The trials of Tessa Jowell

PA

Pronto!

THERE are those who expected Tessa Jowell, minister for culture, media and sport, to lose her job this week. Instead, she got an extra one: that of "Cabinet champion" for reducing the pay gap between men and women.

The appointment was awkwardly timed. While her husband, David Mills, a corporate lawyer, was fending off accusations from Italian magistrates that he had taken a bribe from Silvio Berlusconi, the Italian prime minister, Ms Jowell was busy reinforcing gender stereotyping. She claimed that the family finances, which may have served to bring the cash into the country, were no business of hers. To add to her problems, the Home Office has been accused of not co-operating with attempts to extradite Mr Mills to Italy.

Sir Gus O'Donnell, the cabinet secretary, who was asked by the Conservatives to decide whether Ms Jowell had broken the ministerial code of conduct, cleared her on March 2nd. He ruled that she would have told civil servants about a gift to her husband had she known about it. His statement was intended to put her in the clear; but it may not be enough.

Until a few days ago, Mr Mills's problems were his own. Then the *Sunday Times* produced evidence that Ms Jowell had signed a form authorising a loan of more than £400,000 ($700,000) on one of their houses, which was then invested in a hedge fund. Nothing wrong with that, but it does tie Ms Jowell to her husband's complicated financial dealings, which included serial mortgages, a brace of hedge fund investments and payment from a company in the Virgin Islands. There are still two possible threats to her job.

First, Italian magistrates allege that a sum used by Mr Mills to pay off that mortgage came from Mr Berlusconi, as a reward for testimony that, as Mr Mills wrote to his accountant, "kept Mr B out of a great deal of trouble". Ms Jowell and Mr Mills both say the cash did not come from Mr Berlusconi. If it turns out that it did, she could yet be in trouble. Second, if her husband's investments conflicted with her ministerial duties, Ms Jowell might have to go.

At the moment, these are both hypothetical accusations. Unfortunately for Ms Jowell, they will not go away. New information may come from Italy, where a judge is expected to issue a written opinion on the case against Mr Mills and Mr Berlusconi within weeks. The evidence will then be available to the public, and newspapers will be bound to have a field day publishing pictures of Ms Jowell and Mr Berlusconi on the same page.

Even if Ms Jowell proves blameless, the affair may damage her ability to get on with her job. Her husband's convoluted financial dealings have made her appear remote from Labour supporters and cooled some of her colleagues' regard for her. She needs a big success to shore her up: wiping out the gender pay gap, perhaps?

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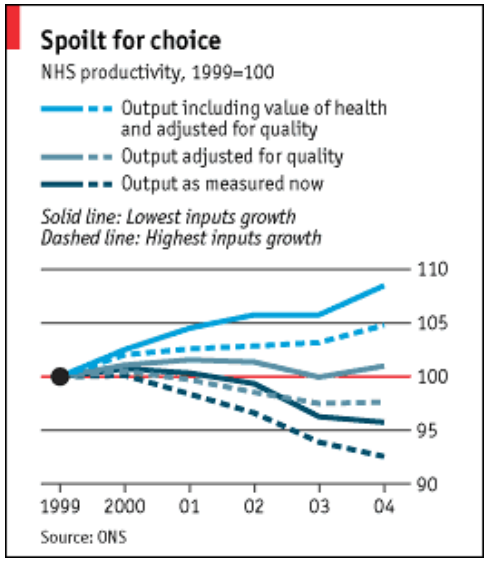
Health-service productivity

Take your pick

Mar 2nd 2006
From The Economist print edition

New official estimates are confusing and misconceived

Get article background



DURING the past seven years, public money has been poured into the National Health Service. Whether or not the NHS has used the deluge of cash productively is a politically charged question that matters hugely to taxpayers and patients. People rightly expect the Office for National Statistics (ONS) to provide a reliable and trustworthy answer.

On February 27th, the ONS served up not one but six answers (see chart). For those of a sunny disposition, NHS productivity—the ratio of health-service output to inputs—rose by 1.6% a year from 1999 to 2004. For those inclined to look on the dark side, it fell by 1.5% a year over the same period. And for those who shun extremes, the ONS had four other variants on offer: annual rises of 0.9% and 0.2% and yearly falls of 0.5% and 0.9%.

As with music and love, so with official numbers and productivity: an excess of them may cause the appetite to sicken and die. However, the ONS says the surfeit of figures is needed after a report in 2005 on measuring public-service output and productivity. That review, in which a team of government officials was led by Sir Tony Atkinson of Oxford University, called for far-reaching changes in methods.

At present, the official measure of NHS output published in the national accounts is based on the number of treatment activities, with more expensive ones being given a higher weight than cheaper ones. It is this estimate that produces yearly declines of 0.9% or 1.5% in productivity, depending upon how inputs are calculated.

However, the Atkinson review said that output should take into account quality. If, say, the number of hospital operations is static but they are becoming clinically more effective, that quality gain should be counted as higher output. Incorporating a range of quality adjustments (all positive) suggested by the Department of Health, produces a 0.2% annual rise in productivity or a 0.5% yearly fall.

The Atkinson review also argued that the output of public services like health and education becomes more valuable as the economy grows. The worth of an educational grade and the value of health rise in line with real earnings, it suggested. Unsurprisingly, the department also advocates applying this principle. Since trend earnings growth is 1.5% a year, it results in the most upbeat of all the productivity figures. Together with the quality adjustments, it gives annual rises of 1.6% or 0.9%.

With its plethora of answers, the ONS report is certainly confusing. A further weakness is that it has accepted the department's output estimates without questioning them. Yet the department's tendentious methods are open to challenge.

For example, the main source of the quality boost to productivity comes from statins, drugs used to lower cholesterol. The department calculates that their benefit to patients is much higher than their cost to the health service. This higher valuation is then used to re-weight statins' contribution to output, which in turn pushes up NHS productivity growth by 0.8 percentage points a year. But as the department itself acknowledges, arguably this gain should be credited to the pharmaceutical industry rather than the NHS.

The notion that public-service output becomes more valuable in a growing economy is also contentious. François Lequiller, head of national accounts at the OECD, says the principle is "new for national accountants". He adds that the majority would prefer to keep it on the research agenda for the time being.

Academic experts are blunter. Barbara Fraumeni, former chief economist at the Bureau of Economic Analysis

(BEA), which draws up America's national accounts, says she doesn't think the principle is a good one. Jack Triplett, also a former BEA chief economist, says that it muddles up price and quantity. The trend increase in the value of health is being driven by rising demand. “The fact that people are willing to pay more for health care doesn't say anything about the quantity that is being provided,” he says.

The ONS is treading on dangerous ground. Britain's crime figures have lost credibility because of conflicting official numbers. Publishing confusing measures of NHS productivity, when there is grave doubt whether the underlying methods are sound, is likely to undermine public faith in official statistics still further.

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Education reform

Tony's test

Mar 2nd 2006
From The Economist print edition

Tony Blair will pass his education exam, but not without Tory help

Get article background

THE Education and Inspections Bill, published on February 28th and due to be voted on in a couple of weeks' time, has become a defining issue in British politics. For the government, it is a test of Tony Blair's ability, honed over a decade, to make the Labour Party do things it doesn't particularly want to do. For the Labour Party, the bill is a chance to define its values and future direction. For the Conservatives, it is the first trial of David Cameron's strategy of separating Mr Blair from his party and hugging him so tight that he expires in Tory arms. For the Liberal Democrats and their new leader, it is a chance to carve out an identity as the most forthright foe of what they hope is an unpopular reform. As for the bill itself, its meaning is probably now best left to literary critics.

When a white paper first aired Mr Blair's ideas for reforming secondary schools, it came with a rousing introduction. Repeating a manifesto commitment, Mr Blair said he wanted all schools to be independent and proposed a new trust structure for schools. He argued that Local Education Authorities (LEAs), the bureaucracies that run many schools, should not be both commissioners and providers of education. Let a thousand choices bloom.

For a large section of the Labour Party this sounded horribly like a move towards a market in education and a way for wicked schools to select their pupils. Both go against Labour notions of equality. In December 2005, 91 Labour Members of Parliament signed up to an alternative white paper, which aimed to improve standards in schools while keeping the bureaucrats in control. (Interestingly, research by Philip Cowley of the University of Nottingham and Paul Cairney at Aberdeen University shows that the signatories are twice as likely to have been to selective grammar schools than the average Labour MP.) Many now hint that they can support the reform in its altered form, while the government insists it has not watered down its proposals. What has changed?

First, there is now no mention of the new trust schools in the bill (they are instead inelegantly styled "foundation schools with a foundation"). The education department claims this is a legal nicety, but it is one that allows Labour opponents of the bill to argue that they have got their way. Second, Ruth Kelly, the education secretary, has promised that schools will not be allowed to interview pupils. Third, the admissions code, which tells schools how they can decide which pupils to take, is to be strengthened.

One remaining area of disagreement, though, is whether the education secretary should retain a veto over LEAs starting new schools. Giving it up would hand power back to local education bureaucrats, weakening the reforms further.

These changes and, more importantly perhaps, the government's newly emollient tone, should be enough to get support for the bill from a large majority of Labour MPs. John Denham, a former minister and a bellwether on education reform, has been won over. Graham Allen, a former Labour whip who also disliked the white paper, thinks the scarier parts have now been removed. Between 40 and 60 Labour MPs are currently thought likely to vote against the government, so the bill will need Tory support to go through. But Mr Blair will be in detention until it does.

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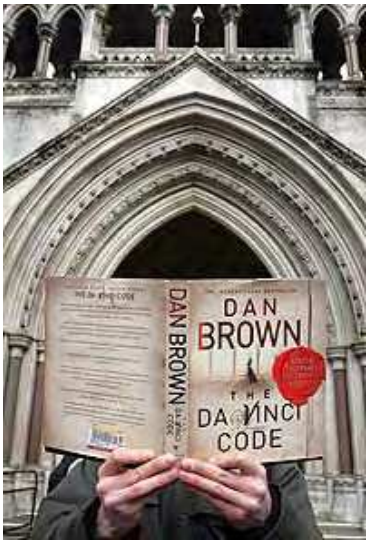
The Da Vinci Code

An intriguing lawsuit

Mar 2nd 2006
From The Economist print edition

Drawing the line between plagiarism and inspiration

Reuters



Stranger than fiction

PUZZLES, intrigue and coincidence dance from the pages of "The Da Vinci Code", a bestselling novel by Dan Brown which claims that Jesus Christ married Mary Magdalene and their descendants still walk the earth. So it is a rich coincidence indeed that very near Temple Church, the base of the ancient Knights Templar, who play an important role in the book, London's High Court is hearing a copyright claim against its publishers. Michael Baigent and Richard Leigh, authors of a near-history, "The Holy Blood and the Holy Grail", allege that Mr Brown copied the "architecture" of his plot from their book, which was first published in 1982.

Lawyers for Mr Baigent and Mr Leigh argue that Mr Brown lifted central themes, such as the notion that Jesus founded a family with Mary Magdalene. Random House, which coincidentally published both books, denies this, adding that some of these allegedly stolen ideas in fact appeared in neither book. Other bits that Mr Brown supposedly copied came from sources available to all three authors, the publishers say.

With millions of copies in print, "The Da Vinci Code" is the most popular novel of the century. A multi-million-dollar film version of it is due to be released in May. It is not unreasonable to assume that Messrs Baigent and Leigh may have mostly money on their mind.

But there are deeper questions at stake in the case, and how they are resolved will affect thousands of writers, especially those who tread the narrow boundary between history and fiction. What are the legal limits to drawing inspiration? Where does history stop and imagination begin? Was Goethe wrong to take the story of Faust from Marlowe, and should Gounod and Berlioz have stood trial for setting it to music?

English copyright law does not protect ideas, only their expression. In a nutshell, lifting the text from another's work is a clear case of plagiarism, and a clear breach of copyright. But in this instance, where Mr Brown is alleged to have copied "themes", the distinction between what can and cannot be protected by copyright is more subtle.

According to Nigel Tait, a media lawyer at Carter-Ruck, "Cases of this kind are very fact-specific. Generally, there is no copyright in an idea...The judge will need to decide whether Mr Brown has copied or borrowed a substantial part of the claimants' work." Central to that will be determining whether the themes and information allegedly copied were available from other public sources, and whether they are too disembodied to be protected by copyright.

At the end of the day, Mr Brown's work is one of fiction, no more and no less. It is "a gripping read," says William Taylor, vicar of St Helen's in Bishopsgate, London, "but it bears little relation either to the picture we have from the historical records after the New Testament was written or to the consensus of modern scholarship concerning the historicity of the original documents."

Fortunately for the judge, he does not have to decide on the blockbuster's historical accuracy. The case continues.

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Company takeovers

More hunted than hunting

Mar 2nd 2006
From The Economist print edition

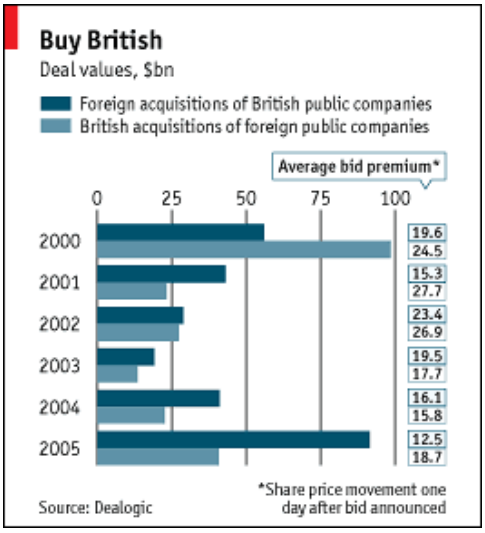
Why British companies are being bought at a record pace

THERE may be companies more stereotypically British than Pilkington, a glassmaker founded in 1826, but it is hard to think of another that so neatly fits the bill: fighter pilots in Spitfires peered through windshields made using its glass in the Battle of Britain; it owes its fortune to a determined inventor who had an epiphany while washing the dishes; and, this week, it was bought by a Japanese company with nary a murmur of protest.

The firm is just the latest in a long list of cross-border takeovers that include both old imperial names such as P&O, a worldwide ports operator bought this month by Dubai's DP World for £3.88 billion ($6.8 billion), and new icons of the information age, such as O2, a mobile-phone company sold to Spain's Telefónica for $31.7 billion.

The surge in cross-border acquisitions of British public companies, which more than doubled from $41 billion in 2004 to a record $91.4 billion last year, is causing angst in some quarters. Critics worry that Britain will lose jobs and skills, and that the net inflow of dividends that has propped up the country's balance of payments will turn into an outflow.

Unlike elected officials in France and Spain, who are trying to bully shareholders into rejecting foreign bids and building national champions (see article), the British government is sanguine, even when airports and defence companies are bought. Instead, it is business leaders who are sounding the alarm. Their concern is not exactly that foreigners are buying British companies, but that they are buying so many and, perhaps, too cheaply. Paul Myners, chairman of Marks & Spencer, a retailer, recently bemoaned in print the short-sightedness of British investors in succumbing to bids.



Britain is not the only country to see a sharp rise in takeovers fuelled by cheap debt. But it does seem that British companies are more hunted than hunting. Over the past five years, foreign firms have spent more buying British public companies than vice versa (see chart). And they may have been buying more cannily than their British counterparts. Last year the average premium over pre-bid share prices paid by foreigners for British public companies was 12.5%, while Britons venturing abroad paid an average premium of 18.7%, according to Dealogic, a research firm.

The first two months of this year show a different picture, but it is too soon to tell whether this signals a change in the trend. That seems unlikely—at least as long as many British firms have to use their spare cash to reduce deficits in their pension schemes or choose to hand it back to shareholders rather than make acquisitions abroad. Royal Bank of Scotland's share price jumped this week when the bank said it had decided to stop buying foreign companies for a bit and start buying back its shares instead.

Why, then, are British companies such attractive targets? The main reason is that Britain's is an open economy with transparent accounting. "You can get information, you can get access and you're not going to get blocked," says Jonathan Russell, head of buy-outs at 3i Group, Europe's largest publicly-traded private equity firm. Another is that shareholdings are widely spread and stocks are liquid, so shares are easily come by. A third, say some, is that British boards often find it safer and easier to accept a bid than to bet on the longer-term future of a company. "Because of a focus on short-term performance, it's extraordinarily difficult to say no to a cash bid," Mr Myners says. For directors, "all the big risks are in turning a bid down knowing the share price will fall."

British companies are also relatively cheap. Their shares trade at an average of 13 times expected earnings, while those of other European firms are valued at 14 times earnings, says Karen Olney, a strategist at Dresdner Kleinwort Wasserstein, an investment bank.

One reason they are cheap has to do with tighter rules on pension funds. More than most countries in Europe,

Britain has an entrenched system of funded, defined-benefit schemes run by companies. Regulators are pushing fund managers to safeguard pensioners' entitlements by matching their assets more closely to their liabilities. In response, institutional investors are selling stocks and buying bonds, pushing share prices down.

Tax and accounting rules in some countries favour local buyers too. Spain, for instance, grants tax relief on acquired goodwill, skewing takeovers in favour of the buyer. "Spanish tax is a big issue," says Ted Scott, a fund manager at F&C, a British asset manager. "We couldn't take out their companies on a like-for-like basis."

Cheaper borrowing costs also help some foreign buyers. Sir John Parker, chairman of P&O, argues that much of the impetus for cross-border takeovers comes from the fact that money is cheaper in continental Europe than in Britain. Having different sorts of shareholders and directors helps too. European firms' shareholders often include the founding families and are long-term holders willing to allow cross-border acquisitions even if they dilute returns, says Brian Magnus, co-head of British investment banking at Morgan Stanley, who last year helped two European companies, Deutsche Post and Pernod, buy Britain's Exel and Allied Domecq.

Still, all good things must come to an end. A growing scarcity of stocks to invest in, along with expectations of more takeovers to come, are driving up the price of those that are left. British firms no longer look quite the deal they once did. Nippon Glass had to raise its offer twice before Pilkington said yes. The next bid could go the full 12 rounds.

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Bagehot

Otherwise engaged

Mar 2nd 2006
From The Economist print edition

The political system needs changing, but it's not why so many people don't vote

NEVER underestimate the importance of fashion in politics. It's nothing to do with Gordon Brown's sudden flaunting of blushing pink ties or David Cameron waggling his Converse trainer-shod feet for an "at home" photo shoot. Political fashion is about ideas whose time has come. Which is why, if nothing else, the timing of the independent Power (as in, to the people) inquiry's report was so immaculate.

Set up in the aftermath of the second general election in a row with low turnout, the inquiry looked into the causes of people's growing disengagement from the political process, and into remedies for it. Chaired by Baroness Kennedy, the unofficial convenor of *bien-pensant* opinion, it produced a 260-page report whose guiding premise is that "the current way of doing politics is killing politics".

Gordon Brown immediately declared that the inquiry, "with its recognition of the responsible citizen", had highlighted "the Britain we must champion and why we must address what holds it back...problems that owe more to our political system than our civic culture." Oliver Heald, the Conservative spokesman on constitutional affairs, added: "We share the commission's concerns about the disengagement felt by many people from the formal political process and the disconnection between the public and politicians."

Both Mr Brown and Mr Cameron hope that by making enthusiastic noises about constitutional reform they will win over the liberal chattering classes, who have never cared much for the Tories and have drifted away from Labour since 1997. But, electoral calculation aside, there is no doubt that the political establishment is seriously worried about what it sees as growing disaffection from the political system.

The weakness of the Power inquiry is not in the reforms it advocates. Many are familiar, but they are none the worse for that: a more "responsive" voting system to replace first-past-the-post parliamentary and local elections; a largely elected second chamber; a cap on political donations; greater resources and independence for select committees; more power for local government, with more freedom to raise and spend tax revenues. Each would be worth doing separately, but, taken together, they could transform Britain's representative democracy for the better.

Unfortunately, the inquiry misrepresents both the nature of the problem and the likely impact of its proposals. It identifies as major issues the rise of executive power at the expense of Parliament, the frustration of political activists who feel they are ignored by party leaderships and the lack of differentiation between the parties.

The argument that Parliament has become ineffectual must have a hollow ring to government ministers. These days, they expect almost as a matter of course to have to bargain and persuade if they are to limit backbench revolts or avoid sabotage by the House of Lords. At best, the argument is out of date, stemming from the distant days when the government had huge majorities and little idea what to do with them. It's also hard to take seriously the suggestion that something should be done to reduce the power of the whips. Members of Parliament are more independent today than at any time in the past 50 years.

Similarly, party members have far more power than before to elect their leaders and choose parliamentary candidates. Whatever the reason why membership of the Conservative Party has fallen from its peak of 2.5m to less than 250,000 today, it's not that members have been made to feel less important.

Nor should the erosion of ideological differences be anything to regret or a reason for people not voting. There were high turnouts during the period of "Butskellite" consensus during the 1950s, and voters punish parties they consider to be extreme, as Labour discovered in 1983 and the Tories more recently. By moving his party to the centre, Mr Cameron expects more rather than fewer people to vote for it.

The commission also falls into the same trap as Mr Brown in believing that the rise of single-issue pressure groups, and the willingness of people to demonstrate against the Iraq war or in favour of ending world poverty, are a source for optimism. It concludes that there is a huge reservoir of political activism and engagement that the parties have been too stodgy to tap into.

But marching for a cause, whether it be opposition to the Iraq war or the ban on hunting, is about protest, emotion and the pleasures of self-righteous solidarity. As an activity, it is far removed from the compromises and negotiations that are the stuff of full-blown politics.

The cynical and the bullied

The real problem, which the commission recognises but shies away from, lies not with the political system at all, but with changes in society itself. As it observes, two contrasting groups have emerged to whom conventional politics has little appeal.

On one hand there are the relatively well-educated, relatively well-informed, relatively young who expect to make their own decisions, find self-expression in buying what they want when they want it, and see themselves as individuals free of geographic, institutional or social bonds.

On the other are the casualties of de-industrialisation who suffer from persistent poverty and social exclusion. The former are cynical about political leaders and irritated that voting is not more like shopping, while the latter feel bullied and let down by the institutions they rely on for their survival.

Constitutional reform of the kind advocated by the Power inquiry is well worth doing for its own sake. But whether it will make much difference to people who are already profoundly detached from the habits and modes of representative democracy is another matter.

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European takeovers

To the barricades

Mar 2nd 2006 | PARIS
From The Economist print edition

Getty Images

A wave of cross-border mergers in Europe provokes a nationalist backlash

Get article background

"IT IS again time to stop the countries of the European Union from erecting national barriers," warned Giulio Tremonti, the Italian finance minister. "If not, we will risk an August 1914 effect... with, at the end, a war that no one wanted." Roberto Maroni, another member of the Italian cabinet, was more defeatist: "Europe is dead," he said, urging Silvio Berlusconi, the Italian prime minister, to do for his country's textile industry what Dominique de Villepin, his French counterpart, has done for France's energy companies.

In a hastily arranged meeting over the weekend at the prime minister's mansion with the chief executives of Suez, a formerly state-owned water and power company, and Gaz de France (GDF), the state-controlled gas giant, Mr de Villepin had told the two bosses to merge their companies. The deal—which would create an energy giant with annual sales of €64 billion ($76 billion) and more than 200m customers on four continents—has been under discussion for more than a year. But Mr de Villepin had considered it politically unfeasible. He changed his mind to pre-empt a hostile bid for Suez by Enel, the biggest Italian electricity firm.

Mr de Villepin denies that he is trying to rebuff the Italians. But, oddly enough, his announcement of the proposed merger came a few days after the boss of Enel had made noises about his interest in Suez, or in Electrabel, a Belgian electricity company owned by Suez. The Italians took the French rejection badly: Italy's industry minister cancelled a meeting on February 27th with his French counterpart. Mr Berlusconi called on the European Union (EU) to intervene against what he regards as blatant protectionism.

But Mr de Villepin is unabashed. On March 1st he announced plans to make big French companies harder to take over, by increasing the shareholdings controlled by the state.

The French furore is part of a disturbing pattern. The Spanish government is taking defensive measures of its own, to try to prevent E.ON, a German energy company, from taking over Endesa of Spain. Like the French, it would prefer to create a national champion from a domestic merger. Nor, despite Mr Berlusconi's protestations, are the Italians innocent of this sort of behaviour: they recently entertained the rest of the world with the soap opera featuring attempts by the governor of the Bank of Italy to prevent foreigners from buying two mid-sized Italian banks. And in Poland the government is trying to block a banking merger driven by foreigners.

An optimistic interpretation is that all this fuss is, in fact, a sign of the success of European corporate restructuring. A European merger wave has been gathering momentum since last year, when firms came out of a period of tough restructuring. Strong corporate profits in 2004 encouraged companies to make acquisitions—particularly since

credit was cheap and plentiful. By the end of 2005 the value of European deals that year had reached almost €1 trillion, a volume not seen since the technology bubble of 2000.

The mergers are also the fruit of the many legal moves taken by the European Union to create a single market. Firms have started to develop Europe-wide ambitions, especially in three fragmented industries—telecoms, banking and energy. A few biggish cross-border takeovers such as Suez's acquisition of Electrabel passed by without much controversy. But as cross-border takeovers have become more common, so they have begun to affect companies governments regard as the crown jewels of their economy. Moreover, this has come just as a new and more defensive political mood has taken hold of the French establishment, following the rejection of the EU's draft constitution in a referendum last May.

In the aftermath of the referendum defeat, the French establishment talked itself into a state of advanced paranoia because of rumours of a bid for Danone, a French food firm, by PepsiCo, an American one. It produced a list of 11 "strategic sectors" it thinks should enjoy legal protection from foreign takeover. At the end of January the French government was surprised by Mittal Steel's hostile bid for Arcelor, a steelmaker with 30,000 employees in France. Then came E.ON's bid for Endesa, which pushed Enel to think about its own cross-border takeover plans—and so created the momentum for the Suez-GDF merger.

Will politicians really be able to turn back the tide of mergers? The French government can do little directly to prevent the Arcelor takeover, since it is neither a shareholder nor regulator of the firm, and steel is not on its recently published list of protected sectors. In any case on February 28th the European Commission in Brussels—which enforces EU law—started to scrutinise France's "security" justification for protecting its 11 sectors. The commission will also be concerned by the increasing number of countries, including Luxembourg where Arcelor is based, that are making it easier to use "poison pill" defences against foreign takeovers. EU officials have also warned the Spanish government against using its "golden shares" to shield Endesa from foreign bidders.

Surge of energy

Top European utility M&A deals, 2003-06

Announced	Target	Nationality	Acquirer	Nationality	Deal status	Value, $bn
Feb 21st 06	Endesa bid 2	Spain	E.ON	Germany	Pending	56.64
Sep 5th 05	Endesa bid 1	Spain	Gas Natural	Spain	Pending	51.71
Feb 27th 06	Gaz de France	France	Suez	France	Pending	43.07
Aug 9th 05	Electrabel	Belgium	Suez	France	Completed	13.87
May 13th 05	Italenergia	Italy	AEM; Electricité de France	Italy/France	Completed	10.33

Source: Dealogic

A clash between the Spanish government and the commission seems inevitable anyway, after the Madrid authorities overhauled Spain's energy regulation to give its national regulator power to block the E.ON bid. And the commission may yet intervene in the proposed marriage of Suez and GDF. A commission spokesman has fretted that France's defensive move has flouted the "spirit of the European internal market"; and the commission says the fact that Suez has less than two-thirds of its European turnover within France could give the EU competition authorities the grounds to intervene.

Some pessimists now see attempts to undermine the single market as a graver threat to the EU than last year's constitutional crisis. Most bankers and analysts are more sanguine. The consensus is that today's backlash will turn out to be the last thrashings of an old order and that it cannot stop further global mergers—increasingly involving Chinese, Indian and Russian firms. The logic for cross-border mergers in Europe may be compelling. But—as some politicians discovered in 1914—economic rationalism is sometimes swamped by atavistic nationalism.

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Dubai

Arabian dreams

Mar 2nd 2006 | DUBAI CITY
From The Economist print edition

The emirate has too much to lose by being a security risk

UNUSUALLY heavy rain stopped play at the Dubai Open tennis tournament last week, one of many glittering sporting events the desert kingdom is using to promote itself as a 21st-century Arabian city. Buckets and mops had to be deployed in some prestigious buildings when roofs sprang a leak and minor floods soaked the floors. It was a small humiliation for a country set on becoming a global centre for transport, tourism and business.

Much worse has been the furore in America's Congress aroused by Dubai's $6.8 billion takeover of Britain's P&O—which comes with the commercial operations of six American ports. The fuss surprised many business leaders in Dubai who thought the deal was all but concluded. Whether or not a new 45-day inquiry into security implications can provide George Bush, who has backed the deal, with a face-saving compromise remains to be seen. For Dubai's state-owned DP World, the purchase could make sense even shorn of the American ports, which represent a small yet important part of P&O. It would still make DP World one of the world's largest port operators, alongside Hutchison of Hong Kong and PSA, Singapore's state-backed port authority.

Yet the backlash in America is a slap in the face for Dubai: a member of the United Arab Emirates, it is trying to do what many western capitalists have long advised—invest in building world-class businesses before the oil runs out. For Dubai, that day is only about ten years away. It has already developed its economy to the point where oil accounts for just 7% of GDP. Under the leadership of the ruling al-Maktoum family, Dubai has made a series of huge investments. Just its most advertised projects amount to well over $50 billion.

In Dubai City the central stump of Burj Dubai is steadily gaining height. The skyscraper will eventually reach around 800 metres (2,624 feet) to claim the title as the world's tallest building. Along the coast are luxury hotels, the Wild Wadi Water Park and new offshore islands, one shaped like a palm and another like a map of the world. (David Beckham, the captain of the England football team, was among the first to buy a property.) Already, more than 5m tourists arrive every year, a number that could easily double with the opening of new attractions: more shopping malls, of course, but also a theme park, twice as big as Disney World in Florida, an indoor ski resort and a recently announced 500-bedroom underwater hotel.

Singapore is the model. It has already proved that combining business with tourism can be a successful formula for a city-state. Like its South-East Asian counterpart, Dubai is now also trying to turn itself into a regional transport hub. Its national airline, Emirates, has won international awards and has the world's largest outstanding order for new aircraft—a mix of Boeings and giant double-decked Airbus A380 superjumbos.

A new company, the Dubai Aerospace Enterprise, was recently unveiled. It will mastermind a $15 billion investment in aircraft manufacturing and aviation services, including Islamic aircraft-financing. It will be based next door to the new Jebel Ali airport, which will eventually have six runways and the capacity to handle 120m passengers a year. One runway will be dedicated to cargo aircraft, which will load and unload at the world's first "logistics city". The new airport is adjacent to DP World's giant Jebel Ali Port, now one of the region's busiest container terminals.

As Dubai's boosters point out, the emirate is well situated midway between Europe and the booming markets of Asia. Can its strategy work? It will take more than first-rate facilities, which is why a liberal business environment is being fostered, alongside an openness to foreign labour. Already some 80% of Dubai's 1.5m inhabitants are expatriates, ranging from Bangladeshis working on building sites to Americans hired as top executives. But the strategy of turning Dubai into an international hub for transport, tourism and international business would be threatened if America decided that Dubai is also a hub for terrorism. That is why, ultimately, Dubai's security concerns are just the same as America's. It cannot afford any compromise on the issue, because that would destroy its dream.

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South Korea

Repel boarders

Mar 2nd 2006 | SEOUL
From The Economist print edition

American shareholder activists get a frosty reception in Korea

Get article background

HOSTILE takeover bids are rare enough in South Korea, and when—even rarer—they are carried out by foreigners, a national uproar is guaranteed. Last week a group of hedge funds led by two American financiers, Carl Icahn and Warren Lichtenstein, suggested taking over Korea's biggest cigarette-maker, KT&G (formerly the state-owned Korea Tobacco & Ginseng, containing units that both kill and claim to cure), with a proposal that valued the company at about $10 billion. After managers turned down their kind offer, the group said it might now launch a hostile bid for the company's shares. The local media are screaming for new rules from the government to protect Korea's virtue from foreign corporate marauders.

Together, Mr Icahn, who has just ended a bitterly fought attempt to break up Time Warner, Mr Lichtenstein, who has had some success with aggressive corporate tactics in Japan, and their allies control about 6.7% of KT&G shares. For months they have been pressing the company's management to boost shareholder returns by spinning off and listing the group's fast-growing ginseng subsidiary, selling holdings of property, getting rid of stakes in a convenience-store chain, a news channel and a drugmaker, and boosting the dividend and buying back shares.

These proposals are reasonable enough, but then the current management strategy is hardly outrageous. At a time when profits from tobacco are taking a tumble, KT&G's executives are conscious of the ginseng business's value. They are probably not averse to spinning it off; but since the company's ginseng monopoly was abolished in 1997, they believe more work needs to be done to make the unit competitive enough to face new entrants. As for the property holdings, much is in the form of farmland. At a time when the government is trying to curb rampant property speculation, the odds of getting the land quickly rezoned for more profitable uses is not high.

The differences, then, are as much about timing as substance. KT&G is no typical Korean company, dominated by family insiders. Some three-fifths of all shareholders are foreigners. The group's corporate governance has won plaudits—the board, for instance, is well stocked with independent directors. And its management strategy finds defenders among foreign shareholders. After all, KT&G's share price has risen by two-thirds over the past year. The dividend yield, at 3.3%, may not be as high as at Reynolds American, that country's second biggest cigarette-maker, but is still much higher than at regional rivals—the shares of Japan Tobacco, for instance, yield a mere 0.8%.

It is hard to gauge the level of support for a hostile bid from other foreign shareholders. KT&G's largest investor, Franklin Mutual Advisers and its affiliate, Templeton Asset Management, have yet to declare their hand. But then, not everyone thinks the raiders are serious about bidding for control. There is no indication that an alternative management is being lined up. And while the raiders say that they have a $2 billion war chest, where the rest of the money is to come from is far from clear. Takeover rules certainly suit raiders, for there is no shareholding threshold beyond which an investor must bid for the majority of a South Korean company's shares.

On March 17th three of the raiders' candidates, including Mr Lichtenstein himself, are standing for election as outside directors to the KT&G board. This proxy fight will give a sense of the raiders' support. Perhaps KT&G will later attempt to buy out the raiders' stake; or perhaps relations between managers and marauders will sink further. Meanwhile, the view of local analysts watching the saga unfold is pretty unanimous: there are more productive ways of getting Korean co-operation than blunt demands and verbal threats.

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Environmental risks

Tobacco, asbestos and now paint

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A ruling in Rhode Island over lead paint opens up a new area of toxic torts

THE chances of making a fortune from a dull old business like paint appeared pretty grim until February 22nd, when a Rhode Island jury decided that three companies were guilty of creating a continuing public nuisance because of lead pigment in the paints they produced before 1978. From that date, the offending products were banned under federal law because of the poisonous consequences that paint dust and chips can have for children.

For the companies involved, the verdicts were devastating. The stockmarket value of Sherwin-Williams, the largest, shrank by more than $1 billion, or 30%. It recovered a little after a judge ruled on February 28th that the three firms involved will not be liable for punitive damages, but the companies will still be liable for clean-up costs that could run to billions of dollars. And that is just in little Rhode Island, and just for paint companies.

Plaintiff lawyers can smell blood. The lead plaintiff, a South Carolina law firm called Motley Rice, is eligible to receive 17% of any settlement, and it may be able to replicate its success elsewhere. Granted, similar litigation has been tried without success in half a dozen states; but plaintiffs recorded several misses before scoring big hits on tobacco, with Motley Rice playing a key role. And, as with asbestos, the list of possible candidates for litigation is only just being drawn up.

DuPont, a chemicals company which also produces paint, managed to extricate itself from the Rhode Island case after a deal involving the payment of millions of dollars to charities approved by the state's attorney-general. Both sides say the deal was not a "settlement", thus relieving DuPont of legal concerns for the moment. The deal seems clever; but other states may reason that DuPont will pay to avoid a trial.

Makers of pigments and paints may be only the start. Lead paint was used in millions of buildings throughout America. Since health hazards typically emerge only in buildings that are badly maintained, landlords with poor maintenance records are an obvious next target. So might be distributors, painters and any other links in the chain between the production of paint and its deterioration into dust and flakes. And behind each of these links is an insurance company. Collectively, insurers are the largest possible source of settlement funds. "The question is, does it snowball like asbestos?" says Jeff Berg, an analyst at Moody's, a credit-rating agency. "There is no way to know this up front."

An answer to Mr Berg's question will come in several stages. First, there is the science. The individual connection between exposure to asbestos and lung disease was pretty clear-cut. By contrast, the main sin that lead is accused of is reducing children's intelligence by damaging the developing brain. That is the sort of effect which shows up at a population level; but it is near impossible to pin the stupidity of a particular child on exposure to lead.

Second is the question of whether the Rhode Island verdict will survive an appeal. Third, plaintiff lawyers will have to surmount several obstacles before they can bring a case. Foremost among these is the awkward fact that no paint was purchased after the ban. Layer upon layer was applied for decades before it, and no one is claiming that the paintmakers did anything illegal. Fourth, if plaintiffs are to win damages courts will have to apportion the bill to existing producers on the basis of their current market shares, because no one knows whose paint was used in which building. A case in Philadelphia was dismissed because the court rejected just this methodology.

Finally, the Rhode Island verdict may not be easy to replicate elsewhere. Its roots go back to 1998, when Ron Motley, a South Carolina lawyer and veteran of the tobacco settlements, met state attorneys-general and identified lead-based paint as a promising area for public litigation. Of the many that attended, only Rhode Island's followed through.

The state was unusual, both because it had lots of old deteriorating houses and because its definition of public nuisance was particularly broad, says Don Gifford, an academic and adviser to the industry. Typically, a public nuisance is just that: polluted air or water, say, or traffic. Merely showing that lots of individuals suffer private harm does not mean the nuisance is public. In Rhode Island, however, almost any harm can qualify.

Curiously, Rhode Island is also one of the few states where the attorney-general has not endorsed moves by the paint industry to minimise the chance of lead poisoning by publishing warnings and providing training on how to

deal with surfaces that may have been coated with lead-based paint. Lead paint is a problem. Sorting out who will pay for it could be another of America's great tort battles.

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Turkey's garment trade

Beyond the veil

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Where Islam and erotic underwear meet

SULTAN ABULHAMID II, who reigned over the bankrupt Ottoman Empire during its final days, had a weakness for French underpants. A pair of these silken knee-length wonders once sported by the Sultan hang lovingly framed in the office of Deha Orhan, Turkey's leading producer of underwear. Had the Sultan lived today, Mr Orhan says, he would have happily settled for Turkish-made knickers, because "they are just as good, if not better".

Turkey is the third-largest exporter of underwear in the world. Revenue from the industry, which employs close to 1m Turks, reached $4 billion in 2004, giving Turkey 8% of the world market for bras, panties and bathing suits—behind China and Hong Kong. Many famous models, including Cindy Crawford, Claudia Schiffer, Heidi Klum and Tyra Banks, first began to gain international attention when—early in their careers—they posed in ads for Zeki Triko, a Turkish swimwear company. Much of the erotic lingerie sold in sex shops across Europe is made in Istanbul.

A predominantly Muslim country may seem an unlikely producer of fur-trimmed G-strings and leather bikinis, but Mr Orhan, whose father established their family-run business "Ten" half a century ago, sees no contradiction. Most of the workers at his factory are women who cover their heads. And the mildly Islamist government that has been running Turkey since 2002 has done nothing to sabotage the industry. Indeed, Ali Babacan, the economy minister, who is also leading Turkey's negotiations to join the European Union, used to be a distributor for "Ten" underwear.

Turkey's textiles industry owes its success to good quality, low production costs, proximity to Europe and investment in technology. But competition from China is increasingly fierce, particularly now China has full access to world markets. Bahri Ozdinc, the chairman of the Turkish Underwear Association, says that energy prices in Turkey are the highest in Europe, and must be lowered if the country is to maintain its edge.

Another problem is that Turkey has no internationally known brands; most Turkish underwear is sold under foreign labels. But in swimwear, one Turkish company is fast making its mark with pious Muslims across the world. Since 1993, Istanbul-based Hasema has been manufacturing Islamic-style swimwear, a first of its kind. For men these are baggy, mid-calf length bathing trunks, which according to Hasema's founder, Mehmet Sahin, "don't outline one's privates". For women, they are Spiderman-type bodysuits with tight fitting bonnets, to cover the hair and thighs. The collection also features special material that enables modest ladies to get a tan without having to undress.

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Text messaging

Getting the message

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Americans have finally embraced texting. What took them so long?

TELEGRAMS have just passed into history in America, following the announcement by Western Union, once the colossus of the industry, that it was discontinuing its telegram service at the end of January. Yet in a sense, the technology pioneered by Samuel Morse has been reborn with a modern twist, in the form of text messages sent between mobile phones. For years, foreigners have wondered why Americans, usually at the vanguard of technological adoption, were so reluctant to embrace texting. But now they have adopted the technology with enthusiasm. What happened?

America's apathy towards texting was easy to explain. Voice calls on mobile phones are cheaper than in other countries, which gives cost-conscious users less incentive to send texts instead; several different and incompatible wireless technologies are in use, which made sending messages from one network to another unreliable or impossible; and texting was often an additional service that subscribers had to sign up for. As a result, the number of messages sent per subscriber per month was just over seven in December 2002, compared with a global average of around 30.

But things have since changed, with that figure rising to 13 in December 2003, 26 in December 2004, and 38 in June 2005, the most recent date for which figures are available from the Cellular Telecommunications Industry Association, an industry body. So America has now overtaken Germany, Italy and France in its enthusiasm for texting.

There are several reasons for this. "We've had that penetration of the youth market," says Brian Modoff, an analyst at Deutsche Bank. "We didn't have that until a couple of years ago." Family calling plans and other new tariffs have put phones in the hands of more young people, who are more likely to adopt texting. There have also been technical changes: GSM, the text-friendly wireless technology used in Europe, has become far more widespread in America as operators have switched customers to it from older technologies, notes John Tysoe of The Mobile World, a consultancy. Interconnections between networks have improved too.

But perhaps the most surprising factor is the role of reality television—and in particular, "American Idol", a talent show in which viewers phone in to vote for competing singers. In 2004, 13.5m viewers cast votes by text message—nearly half of them using the technology for the first time. Last year the number of votes was 41.5m. "That upward arc is a fair indicator for the acceleration in growth of texting in general," says Mark Siegel of Cingular, America's biggest mobile operator. Even when viewers do not vote by text themselves, such programmes raise awareness of texting in general, says Mr Modoff. Whatever you think about the music, "American Idol" has undoubtedly helped Americans to discover a valuable new talent.

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Internet infrastructure

Chinese walls

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China threatens to fracture the internet

THE internet is supposed to be strong enough to survive a nuclear war, but nothing can protect it from politics. Since its inception, its technical underpinning—the handling of addresses such as .com or .org—has been based on an informal consensus among (mainly American) engineers. Yet as governments have come to appreciate the importance of the internet, those delicate agreements are starting to unravel.

On March 1st China moved ahead with three new internet-address suffixes in the Chinese language, as national variants to .cn, .com and .net. This means that Chinese users can type Chinese characters for website and e-mail addresses, liberating them from the strange squiggles of the Roman alphabet, upon which the current addressing system is based.

Since most internet users today are not native English speakers, introducing other writing systems looks like a matter of digital decency. China's action will surely be repeated elsewhere—many countries have experimented with similar things but have resisted a full roll-out. But their reason for stopping short of deployment shows why China's move is potentially troubling. Unilaterally creating new addresses threatens the principle that any machine should be able to talk to any other. China's action is a protest against the way the internet is run.

The internet is managed by a private-sector body, the Internet Corporation for Assigned Names and Numbers (ICANN), operating under the authority of the American government. Many countries oppose this, and argue that the internet should be managed internationally, as is the telephone system. Indeed, China's Ministry of Information Industries, via the *People's Daily*, trumpeted the new scheme as a way to bypass ICANN.

As yet, it does so only symbolically. The new Chinese addresses are still designed to function through the ICANN-sanctioned system, according to a senior Chinese engineer familiar with the initiative. And underneath the names the system continues to use numerical internet-protocol addresses doled out by ICANN. Moreover, the Chinese addresses are considered "temporarily set" in place; designed in other words, to rattle a sabre at ICANN (and America), not spear it in the belly—for the time being. Even so, China's actions threaten not just ICANN's legitimacy but the universality of the internet itself. "I hope that our colleagues in China will value the importance of global internetworking as highly as I do," says Vint Cerf, the chairman of ICANN and one of the internet's founding fathers.

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Face value

The restaurant tsar

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Tass

Arkady Novikov's career offers a history of post-Soviet Russia through its restaurants

AT THE corner of Malaya Bronnaya and Bolshaya Bronnaya streets, in the now-plush area of Moscow known as Patriarch's Ponds, stands a statue of two nestling storks. For decades, the building behind the statue has intermittently housed an eatery named Aist (stork). In the late 1980s and early 1990s, the street corner and the Azeri canteen that then stood on it were infamous for the bloody shoot-outs they hosted between rival Caucasian gangs. "Life was different then," says Arkady Novikov, who with his partners re-opened a restaurant on the spot at the beginning of this year; "people were different." The menu in Mr Novikov's latest venture is European, the decor lush, and in the evenings the junction outside is swamped with BMWs and tinted-windowed jeeps, drivers and bodyguards snoozing on the front seats as their burly bosses dine with expensive ladyfriends. But Mr Novikov kept the old name—Aist—and the statue of the storks. "This is our history," he says; "maybe it's good, maybe it's bad." The nod to the past, he says, makes business sense, too: Muscovites come to see what has become of the old shooting ground.

As much as their obsession with novelty, Russians' powerful nostalgia has been part of Mr Novikov's rise to become his country's best-known restaurateur. With his various partners he runs more than 100 restaurants, employing more than 11,000 people. Yet as a youngster, he says, he dreamed only of working as a chef in a Soviet embassy; he joined the Party, and rose in the *Komsomol*, the communist youth league. He had "a very ordinary Soviet upbringing": an academic mediocrity, he ended up at culinary college, then did his military service in Georgia and at a dog-training school. By his own account, he lost an early job after sharing a dish reserved for high-ranking visitors—a classic Russian confection of beef, cheese, sour cream, mushrooms and potatoes—with ordinary Moscow customers. When McDonald's opened its first Russian branch Mr Novikov applied, proudly telling his interviewers about the various cuisines he could cook. "They said they'd call me back," he says, "but they didn't."

Then in 1992, after some sharp barter deals, Mr Novikov opened his first restaurant. Called Sirena, it made use of the kitchen of a defunct canteen—adding a dining room in the style of a wooden galleon, plus a vertiginous glass floor with an aquarium below. It was (and is) a good example of the exuberant, eclectic and downright weird forms taken by early Russian ventures into consumer capitalism. Another of his oldest restaurants, and one of the most enduringly successful, is Uzbekistan, which draws on Muscovites' fondness for the food and atmosphere of the ex-Soviet states (and for belly dancing). Mr Novikov says he is planning a new retro-Soviet restaurant, with a retro-menu and mid-meal dancing. The actual food, he says, is less important to Russian restaurant-goers than it is to diners in the West.

Exuberant excess is not yet out of fashion in Moscow. A mega-restaurant named Turandot (not one of Mr Novikov's) also opened recently, not far from Aist. An orgy of phantasmagoric rococo, chandeliers, tapestries and chinoiserie, it boasts opulent private rooms for serious oligarchic entertaining (although the prices are surprisingly

moderate, if you avoid the lobster and the shark-fin soup). But—in keeping with the evolving tastes of his clientele—most of Mr Novikov's recent Moscow restaurants are much lower-key. Many offer sushi alongside their "fusion" fare: an odd—and, in a city so far from the sea, potentially perilous—Moscow obsession that, like curry in Britain, has become almost a national dish. Mr Novikov tried to resist sushi, he says, but "I lost the fight." He has been an early exponent of other imported ideas: last year he was the front man for the Russian version of the reality television show, "The Apprentice". In each episode, Mr Novikov had to "fire" one of the contestants, competing for a job as a restaurant executive. "Sometimes it was hard," Mr Novikov smiles, but "sometimes I fired them with pleasure."

Let them eat sushi

Moscow's massive inequality is a blessing for its high-end hostelries: there are plenty of rich Russians to patronise them and more than enough poor ones to make labour cheap. But Mr Novikov's growing culinary empire is evidence also of something in between: the long-elusive Russian middle class. His pricey restaurants cater to the thickening wedge of wealthy Muscovites, among whom his name is a totem of quality. But he also has a variety of cheaper chains, where ordinary Russians with modestly rising incomes can, he says, eat well for 500 roubles (about $20). He has stakes in assorted grocery shops and delicatessens, and markets his own produce, grown at an old collective farm outside Moscow. And he has an interest in Pyat Zvezd (five stars), a new sandwich-shop chain with a logo and menu that are strikingly similar to those of Britain's Pret A Manger.

As for any swiftly successful entrepreneur, imposing his personality on each of his outlets is a struggle. He has no office, and visits his restaurants in rotation. One eatery is the ideal number for a single restaurateur, he says; five may be the limit of the feasible. But, apart from those troubles that come with success, the perils of doing business in Russia have eased during his career. When Sirena opened, there was a spot of bother with some extortionate bandits; now, says Mr Novikov, Russia is "becoming more law-abiding" (even if the bureaucratic hurdles have increased). Still, not everything has changed in Russia and its restaurants. Mr Novikov insists that the offhand service that often distresses visitors to Moscow is improving. But he concedes that surliness endures, even among waiters and waitresses who grew up in the privatised, post-Soviet years. Grumpy service, Mr Novikov laments, is a sort of congenital national defect—one that he attributes to the mysterious Russian soul.

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Hedge funds

Growing pains

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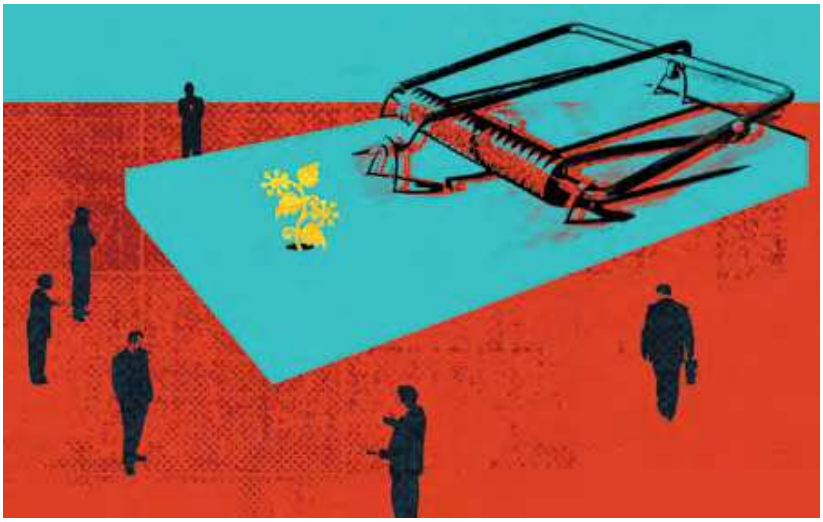


As institutional investors move in, hedge funds are losing some of their rough edges—and their spectacular returns

IN QUIET moments veteran hedge-fund managers sound a little wistful these days. Being a "hedgie", they reflect, isn't as much fun as it used to be. This may seem hard to believe, since many hedge-fund managers are very rich indeed. Steven Cohen, a hedge-fund star in Greenwich, Connecticut (the industry's main cluster in America) took home more than $500m last year. Plenty of others have pocketed $100m or more.

Much of the nostalgia is for an era of spectacular returns. Last year, overall returns in hedge funds were modest at best (although 2006 is off to a stronger start). But something more profound is going on: hedge funds are growing up. What once was a cottage industry is being institutionalised. The mix of investors has changed dramatically in the past five years, and that has led to big shifts in everything from fund size to competition, risk profiles, transparency and—horrors!—regulation.

That has raised a paradox: can the industry be big and yet retain the innovative, risk-taking culture that produced the returns which, in turn, encouraged more conservative investors to invest in it? There are signs that some leading fund managers are limiting the size of their funds because they think big money is incompatible with their way of doing business. Meanwhile, hedge funds face other pressures. New investors are more demanding and, curiously, risk-averse, which is forcing some hedge funds to change their investment style. And competition is growing, as more traditional fund managers introduce products that mimic hedge funds and crowd the market, making it harder to distinguish a genuine hedge fund from a souped-up traditional fund.

Amid all the change, regulators are looking more closely at the sector than in the past. This week Britain's Financial Services Authority (FSA) levied a £1.5m ($2.6m) fine against GLG Partners, a hedge fund based in London, and one of its traders, for improper securities trading. French regulators are reportedly also investigating GLG and its co-founder Pierre Lagrange, along with other big London-based hedge funds, for alleged insider trading. Such scrutiny is yet another restraint on hedge funds' buccaneering culture.

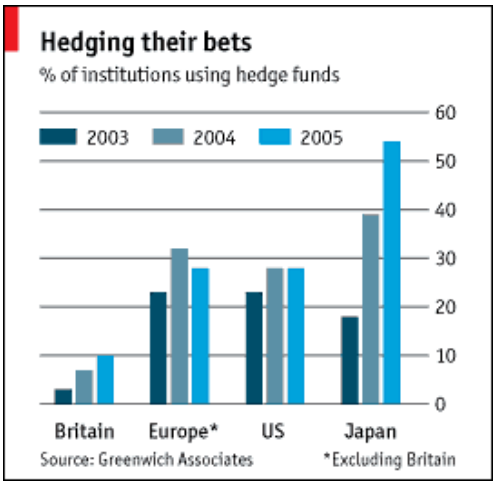
The changing investor mix is one reason why regulators are watching the sector more closely. Until recently, hedge funds were the exclusive preserve of rich Texans, Arab sheikhs and family offices of the super-wealthy. These investors put their millions in the hands of entrepreneurial fund managers who promised—and often delivered—stellar returns whilst offering almost no explanation of how they did it.

Today's hedge funds are increasingly monitored by professional managers at pension funds, endowments, foundations and even central banks—a much less colourful and vastly more demanding bunch. This new group of investors controls sums huge enough to make the assets of most hedge funds look like rounding errors. In short,

they are investors with clout.

Today 50-60% of hedge-fund assets come from institutions, reckons Oliver Schupp, president of the Credit Suisse/Tremont Index, an indicator of fund performance. This trend is most pronounced in Japan and, to a lesser extent, pockets of continental Europe. In America, where the bulk of hedge funds are based, endowments and foundations embraced the sector early on, whereas other institutions were more tentative. Britain has the smallest take-up by institutional investors, although London is a big base for hedge-fund managers. "There's been much more cynicism among UK investors, due to the lack of transparency," says Dominic Rossi of Threadneedle Asset Management, an investment firm that manages traditional as well as hedge funds.

Institutional money has helped the sector to balloon. There are more than 8,000 hedge funds today, with more than $1 trillion of assets under management. Institutions are increasingly attracted to two sorts of hedge-fund providers, says William Wechsler of Greenwich Associates, a consultancy: firms with multiple hedging strategies on offer and research to back up their claims, such as Bridgewater Associates; or traditional fund managers such as Barclays Global Investors (BGI) and State Street Global Advisors that have added hedge-fund products in recent years. In America, he notes, there has been a net outflow of institutional money recently from so-called "funds of funds", which offer a mix of hedge-fund investments in one product to diversify risk, but also add another layer of fees.



Although there is a stronger institutional feel to the hedge-fund business today, that is not to say the cult of personality has disappeared. Most funds are clustered near a few places, such as Connecticut and London, and there is a steady buzz about the latest manager to jump ship and start his own firm. Even university-endowment managers are getting in on the act: Jack Meyer, formerly head of Harvard University's endowment fund, recently raised a record $6 billion for his start-up hedge fund. Paul Allen, a co-founder of Microsoft, has reportedly put $1 billion of his own money into a new firm being launched by Mike McCaffrey, who as chief investment officer at Stanford University helped that entity's $14.3 billion endowment to earn double-digit annual returns for a decade. Other hedge funds have launched with "star" power from investment banks. Eton Park Capital is run by Eric Mindich, formerly of Goldman Sachs, and Cantillon Capital was started by William von Mueffling, previously a successful portfolio manager at Lazard.

Indeed, the industry is still largely driven by personalities and reputations. Investors are backing the managers they believe can find and exploit inefficiencies or wrinkles in the market better than anyone else. How to reconcile the reality of this large and increasingly conservative sector with its swash-buckling and secretive image? "Perception always takes a while to catch up with reality," says Stanley Fink, chief executive of Man Group, a global asset-management firm with a big stable of hedge funds. "The days of 30%-plus returns for hedge funds are long gone," he says. "The Wild West is over."

Expectations of annual returns have certainly changed: ten or 15 years ago, investors "wanted 30-50% returns and could handle the down years," says Jerry del Missier of Barclays Capital, an investment bank. Now pension funds will settle for 8-10% returns, but want less volatility. In general, he says, "people have stopped looking for the drama."

That is not to suggest things are dull. Hedge funds are popping up everywhere, using their muscle in takeover battles and shareholder revolts. Secrecy and limited regulation remain hallmarks of the sector. But some industry observers suggest the activism and other high-profile tactics—admittedly, still practised by only a small fraction of hedge funds—are evidence that the industry has become more mainstream. For some, activism can be very profitable: the Children's Investment Fund Management, a London-based fund that led a successful shareholder revolt against incumbent managers at Deutsche Börse in 2004, had net returns of 43% that year and 50% in 2005.

Overall, though, hedge-fund returns have been far from stellar in recent years. The Credit Suisse/Tremont Hedge Fund Index rose a mere 7.61% in 2005, on the heels of a relatively lacklustre 2004. A recent study by Harry Kat and Helder Palaro of Cass Business School in London says that in recent years fewer than one in five hedge funds gave investors returns above what they could have made themselves trading the S&P 500 stock index, Treasury bonds and Eurodollar futures. The pace has picked up at the start of 2006—the index was up 3.23% in January, the strongest monthly performance since August 2000—but overall returns are unlikely to be stunning.

Surprisingly, given the hype surrounding the sector, there was probably a modest net outflow of money from hedge funds in 2005. Exactly how much left is unclear, because the industry lacks a central database. Attempts to generalise are complicated further by the fact that hedge funds are actually a collection of different investment strategies (see article) rather than a coherent asset class.

Nevertheless, much of the money that came into the industry was from institutions. The $200 billion CalPERS

Retirement system, one of America's biggest investors, recently doubled the size of its hedge-fund investments to $2 billion. Also in California, the San Diego County employees' retirement association, America's top-performing big public-retirement fund over the past decade, has about one-fifth of its total assets ($1.3 billion) in various hedge funds, roughly the same share as in the big university endowments.

Given the mediocre returns, why are institutions investing? Partly because of poor returns in other asset classes and the herd's sense that others have made a lot of money from hedge funds. But their belated arrival also signals slow decision-making processes—changing the strategy of a big institutional investor takes time.

According to a recent report on European investors by the Centre for Risk and Asset Management at EDHEC, a French business school, diversification is another powerful reason why institutions think they should invest in hedge funds. The study found that hedge funds had low correlations with other investments. Other advantages cited by institutions included hedge funds' low volatility, lack of correlation with economic cycles, and the extreme risks they can afford—presumably in the hope of making big returns.

Well matched

Pension funds have been particularly keen to diversify as they struggle to address a longstanding mismatch between their assets and long-duration liabilities. Mark Tapley, a pension-fund adviser and administrator at the hedge-fund centre run by London Business School (LBS), notes that consulting actuaries are searching for liability-matching strategies. He says there is a more intense search for what is known as "alpha" (returns above those of the relevant market index).

Some investors remain sceptical. "We're very nervous whether we have the skills to identify the hedge-fund managers with the right strategies, as opposed to those who are lucky or have a good story to tell," Penny Green, a trustee with a British university employees' pension scheme, told an industry conference recently. Other institutional investors complain about a lack of understanding about investment techniques, a shortage of staff to investigate alternatives and worries about corporate governance (including potential lawsuits). "People want to know exactly how you're making your money," says Fred Dopfel of BGI. He says institutional investors need to know exactly how hedge-fund strategies fit with the rest of their portfolios. They also seek a clear separation of returns: "Market exposures are cheap," he says. "Alpha is expensive." In other words, hedge-fund managers charge a lot to beat the market average.

A typical fund's compensation structure involves a 1% or 2% management fee (a few have stretched the limits with 3%, but investors balked), plus fees paying out 20% of performance. In Europe an estimated 75% of institutional investors with hedge-fund assets are in funds of funds. Increasingly, though, multi-strategy funds are attracting more interest.

The size of individual hedge funds is a growing concern for fund managers. "Once you become large it starts hurting, for a variety of reasons," says Narayan Naik, director of the hedge fund centre at the LBS: "No market is anonymous when you need quantity." Automated trading programs have proliferated, as funds increasingly flood exchanges with multiple small orders, in order to camouflage their trading strategies.

Several studies last year were pessimistic about the industry's ability to generate long-term returns as it grows larger. More and more retail investment funds are capping their sizes in an effort to protect their agility and performance. Mr Meyer's fund, Convexity Capital Management, has reportedly decided to accept no more than $1 billion per year in new investments over the next three years.

As hedge funds get bigger, the worry is that managers will also become more cautious. For a growing number of managers, the main goal is "not to make mistakes," says Matthew Ridley of Consulta, a family office and investment firm. He notes that managers of large funds can live nicely on management fees alone. For retail investors and those institutions seeking edgier strategies or a personalised approach, he recommends smaller funds.

Mr Fink says he, too, worries about managers becoming too risk-averse. A shift into "asset-retention mode", he says, is "the kiss of death". Man Group has dealt with the difficulty by offering two sorts of hedge funds, he says: those that provide more transparency and lower returns, and those that are more opaque, focused and likely to give higher returns—for example Man Group's AHL Fund, a managed-futures fund that uses automated "black box" trading to invest in more than 100 futures markets across the world. It returned 14.3% in 2005, and has had average returns of 18.1% since it started.

Time to trim

Regulatory oversight of hedge funds remains relatively light, but there are signs that it, too, may grow more burdensome. Although hedge funds can set up almost anywhere, fund managers still like the marketing value of the imprimatur of America's Securities and Exchange Commission (SEC) or Britain's FSA. The SEC's fund-

registration deadline on February 1st, which also affected large foreign funds with numerous American investors, was resisted by the industry, but stricter regulations are probably inevitable when retail investors' money is at stake.

Many observers predict consolidation among hedge funds in years to come. The liquidation rate of funds surged last year. Others have been bought out in whole or part by bigger businesses: Legg Mason, a big mutual-fund firm, bought Permal Group, a hedge-fund firm, for about $1 billion last year; ABN Amro, the banking group, bought out International Asset Management, one of London's oldest fund-of-fund managers, in January; and the derivatives unit of American International Group, an insurance giant that already has a fund-of-funds unit, bought a 4.3% stake in Aspect Capital earlier this month. The trend makes sense to those who watch the industry closely. “There are too many managers chasing too few opportunities,” says Mr Naik. “Everyone is using the same models.”

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Hedging terminology

What's in a name

Mar 2nd 2006
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The label "hedge fund" is getting fuzzier by the day

WHAT exactly is a "hedge fund"? In essence, it is a managed pool of capital for institutional or wealthy individual investors that employs one of various trading strategies in equities, bonds or derivatives, attempting to gain from market inefficiencies and, to some extent, hedge underlying risks.

Hedge funds are often loosely regulated and usually are much less transparent than traditional investment funds. That helps them to trade more stealthily. Funds typically have minimum investment periods, and charge fees based both on funds under management and on performance.

Many experts contend it is a mistake to talk about hedge funds as an asset class; rather, the industry embraces a collection of trading strategies. The appropriate choice of hedging strategy for a particular investor depends largely on its existing portfolio; if, for example, it is heavily invested in equities, it might seek a hedging strategy to offset equity risk. Because of this, discussion of relative returns between hedge-fund strategies can be misleading.

Hedge funds use investment techniques that are usually forbidden for more traditional funds, including "short selling" stock—that is, borrowing shares to sell them in the hope of buying them back later at a lower price—and using big leverage through borrowing.

The favoured strategies tend to change. "Previously the hedge-fund industry was equity driven, but now there is less long/short," says Oliver Schupp of Credit Suisse/Tremont Index. "Now it's a much more diverse picture with less concentrated exposure." Some of the most common strategies include:

• **Convertible arbitrage**—This involves going long in convertible securities (usually shares or bonds) that are exchangeable for a certain number of another form (usually common shares) at a preset price, and simultaneously shorting the underlying equities. This strategy did very well for several years, but has been less effective recently.

• **Emerging markets**—Investing in securities of companies in emerging economies through the purchase of sovereign or corporate debt and/or shares.

• **Fund of funds**—Investing in a basket of hedge funds. Some funds of funds focus on single strategies and others pursue multiple strategies. These funds have an added layer of fees.

• **Global macro**—Investing in shifts between global economies, often using derivatives to speculate on interest-rate or currency moves.

• **Market neutral**—Typically, equal amounts of capital are invested long and short in the market, attempting to neutralise risk by purchasing undervalued securities and taking short positions in overvalued securities.

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Euro-area interest rates

Serious business

Mar 2nd 2006
From The Economist print edition

The ECB's second interest-rate rise in three months is not as mad as it seems

IN THE few days before Lent the stereotype of Germans as a people without humour takes a thorough pasting. In the Rhineland and the south, it's carnival time. The streets are filled with parades of elaborate floats, there's lots to eat and drink and nobody does a stroke of work. Men in ties are liable to have them snipped off by scissor-toting women. On Ash Wednesday order is restored. This year the European Central Bank (ECB), in Frankfurt, did its bit for renewed sobriety. On Thursday March 2nd its mainly male policymakers tightened their (intact) neckwear and raised interest rates by a quarter-point, to 2.5%.

Although the increase, the second in three months, was widely expected, many commentators think it was a mistake. In the fourth quarter of last year euro-area GDP growth slowed sharply, to only 1.2%. German consumer spending fell for the fourth quarter running, the first time this has happened since at least 1960. Inflation seems to be under control. New figures this week showed that the euro area's core rate of inflation (ie, excluding energy, food and tobacco) fell to only 1.2% in January, the lowest for nearly five years.

Nevertheless, the ECB has some sound reasons for tightening policy. First, it places more weight on the headline rate of inflation than on the core measure. At 2.3%, the headline rate is well above the bank's target of close to, but less than, 2%. The ECB remains worried that rising energy prices will feed into general prices.

Second, even after this rate rise, policy is lax by past standards, despite what the ECB's critics say. Real interest rates (ie, after allowing for inflation) have been negative for the past two years and even now are barely positive (see chart). In other words, monetary policy is still stimulating demand. A super-loose policy was necessary when there was a risk of deflation, but not now. It therefore makes sense to nudge rates gradually back to more normal levels. Most economists think that the "neutral" rate of interest, which would neither stimulate nor restrain demand in the euro area, is now more than 3% (in nominal terms).

The ECB is also more confident that economic growth is picking up. GDP figures are like a glance in the rear-view mirror: they tell you where the economy has come from, but not where it is or where it is going. Experience also suggests that first estimates of GDP growth are almost always revised upwards. This is why policymakers now pay close attention to surveys of business and consumer confidence.

The index of German business confidence calculated monthly by Ifo, a Munich research institute, is at its highest since the post-unification boom in 1991. If the index's past relationship with GDP held, it would signal growth this year of 3-4%. Admittedly, businessmen's glee partly reflects their optimism about global growth prospects and their profits are benefiting from production in low-wage countries. This may make the Ifo index a less useful guide to domestic economic prospects than it used to be. Nevertheless, the surge in the index is not confined to

manufacturing: in particular, retailers are more confident than they have been for six years. Surveys of German consumer confidence have also perked up this year.

Germany, however, is not the whole zone. Some economists think that Germany is growing largely at the expense of its euro-area neighbours, thanks to improvements in its competitiveness. If that were right, prospects for the zone as a whole would be little brighter. It is true that Germany has a big current-account surplus, while France, Italy and Spain all have deficits, and this might suggest that production is being shifted to Germany.

Yet business and consumer confidence seem to be picking up across most of the euro area. The European Commission's industrial and consumer survey for February found that economic sentiment improved in France and Italy (the second- and third-biggest economies) as well as Germany. Perhaps the best news was a rise in employment expectations of both industrial and service firms. Economists at J.P. Morgan forecast that Germany's GDP will grow at an annual rate of 2.7% in the first half of 2006, and the euro area's by 2.6%, well above the 1.75-2% range in which most estimates of its sustainable potential lie.

Money, it's a crime

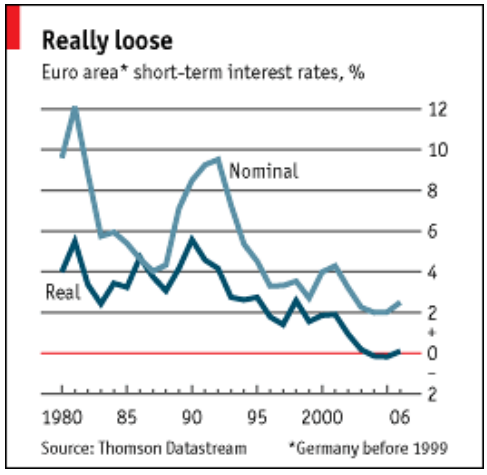
Another important factor behind the rate rise is that compared with other central banks the ECB keeps an especially close eye on the growth of money and credit, which can provide useful information about longer-term inflation risks. In the year to January, lending to households grew at an annual rate of 9.4%, the fastest since 2000. The pace of growth of M3, the broad measure of the money supply, quickened to 7.6%. It has been well above the ECB's target for five years.

The central bank's immediate concern is that excessive growth of money and credit can spill into asset prices. European share prices have climbed quickly in the past year, with German equities up by almost 40% since January 2005. But an article in the bank's latest *Monthly Bulletin* shows that it is the housing market that the ECB is watching most keenly.

Recent years have seen big jumps in home prices in France, Spain, Italy and Ireland. A stagnant market in Germany limited the average rise across the euro area last year to 7%, much less than in America (see article). The ECB frets that households may be borrowing too much to buy homes; if house prices fall in future, the zone's economies could be hurt. It estimates that in 2004 the average property in the euro area was overvalued by at least 15%, and homes in Spain and France by almost 30%. Property is surely even more overvalued by now.

This does not mean that the ECB is about to start targeting house prices, but it is another reason for it to make monetary policy a bit less loose. After all, inflation would be about half a percentage point higher if house prices were included in the euro area's consumer-price index, as they are in America.

Financial markets are betting that interest rates will rise to 3% by December. Capital Economics, a London research firm, expects them to reach 3.5%. That would still be low by past standards and less than America's current 4.5%. For most of the euro area, the effect on demand would be modest. But there are two worrying exceptions. In Ireland and Spain home prices are the most overvalued in the zone; worse, the bulk of mortgages are at variable rates. Elsewhere, most mortgage rates are fixed. A rise in ECB rates from 2% to 3.5% seems modest, yet it implies a rise in mortgage interest payments (assuming a rate one percentage point above the central bank rate) of 50%. Irish and Spanish borrowers have taken on so much more debt in recent years that their extra payments would correspond to an increase in interest rates in the early 1990s from 10% to 15%—enough to cause considerable pain.



If rising interest rates hurt these economies by much more than those of Germany, France and Italy, there will be nothing the ECB can do to lessen homebuyers' misery. Its job is to set rates for the whole of the euro area. Having enjoyed the benefits of Europe's "one size fits all" policy when money was cheap, Ireland and Spain are about to suffer the cost.

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Global house prices

Soft isn't safe

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From The Economist print edition

Homebuyers can lose money even if house prices do not fall

THERE have been a lot of moves up and down *The Economist*'s global house-price league in the past couple of years. In 2003 Australia and Britain topped the table with 12-month rises of around 20%. But prices there have since levelled off and in the past year have broadly kept pace with inflation (see table). Hong Kong has also tumbled down the league: after a 30% jump in 2004, prices have risen by only 5.8% in the past 12 months and since last summer have even fallen. In the past year house-price inflation has also fallen by more than half in South Africa and China, and slowed from 17% to 13% in Spain. The new high flyer is Denmark, where prices are 17.7% higher than a year ago, followed closely by New Zealand (16.8%).

The Economist's house-price indices

% change	latest	Q4 2004	1997-2005
	on a year earlier		
Denmark	17.7	11.8	83
New Zealand	16.8	12.2	85
South Africa	14.9	32.5	279
France	14.7	15.9	112
Spain	12.8	17.2	156
United States	13.0	12.0	91
Sweden	10.5	10.0	103
Ireland	10.2	9.7	212
Belgium	*na*	9.4	71*
Italy	7.3	9.7	81
Netherlands	6.0	2.4	87
Hong Kong	5.8	29.5	-45
Canada	5.7	6.2	52
China	5.1	10.8	*na*
Singapore	3.9	0.9	*na*
Britain	3.7	14.3	167
Australia	2.3	0.2	118
Switzerland	1.6	2.2	15
Germany	-0.8	-1.3	-1
Japan	-4.7	-6.0	-30

*1997-2004

Sources: ABSA; Bulwien; ESRI; Japan Real Estate Institute; Nationwide; Nomisma; NVM; OFHEO; Quotable Value; Stadim; Swiss National Bank; government offices

America's boom also remains strong, with prices up by 13% in the year to the fourth quarter. But there are signs that the market is cooling. Sales of existing homes fell for a fifth month in January, to the lowest for nearly two years, Stocks of unsold homes rose to 5.3 months' supply (from 3.7 a year ago), the most since 1998.

Ian Morris, an economist with HSBC bank, calculates that about half of America's housing market is experiencing a bubble, with prices overvalued by almost 40% even after taking account of low interest rates. Homes in California and Washington, DC, are overvalued by 50%.

That house prices in Britain and Australia have flattened rather than slumped has encouraged most commentators to expect a soft landing in America too. However, that could still mean a hard bump for the economy and for many homeowners.

As British property prices have levelled off, the annual growth rate of retail sales has plunged from 7% to 1%. Mr Morris calculates that even a perfect soft landing in America, with flat house prices across the country, could cause home sales to drop by 30-40%. In turn, mortgage equity withdrawal, which has been financing much consumer spending, would then dry up, creating a drag on growth equivalent to more than 3% of GDP.

British homeowners may comfort themselves that, contrary to *The Economist*'s predictions, prices have not fallen. With homes still remarkably dear, prices could yet fall. Next worst, they could stagnate for a long time. And even then, housing investors could lose because transaction costs such as estate agents' and solicitors' fees and stamp duty are so high.

Suppose you bought a flat in London for £500,000 ($870,000) and sold it five years later for the same amount. You might think you've got your money back; in fact, you have lost a tidy sum. Suppose that you put down a deposit of £50,000 and took out an interest-only mortgage. Stamp duty, legal fees and other costs on the purchase were almost £20,000; five years' maintenance cost £10,000. Your selling costs were then, say, £15,000. Of your £50,000 deposit, you now have £5,000—a 90% loss. Had you simply put the cash in the bank, you would have made 20%.

Worse, because rental yields are so low, you have paid more in interest over the five years than you would have done in rent. In most other countries, where transaction costs are typically twice as large as in Britain, the loss could be bigger still. Investors be warned: even if prices do not fall, housing is not, so to speak, as safe as houses.

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The World Bank

Just saying no

Mar 2nd 2006 | WASHINGTON, DC
From The Economist print edition

Paul Wolfowitz takes on graft

"CORRUPTION" was once a word that the World Bank did not use. Its staff spoke instead of "implicit taxes" or "rent-seeking behaviour" lest they be accused of meddling in politics. A decade ago James Wolfensohn, then the Bank's president, broke the taboo with a speech about the "cancer of corruption" and began a campaign to improve poor countries' governance. His successor, Paul Wolfowitz, has gone even further. Battling graft is his top priority.

Not everyone thinks Mr Wolfowitz, who took over last June, is going about it the right way. Most recently, he tried to tighten the anti-corruption strings attached to debt relief for the Republic of Congo. That country has a notoriously corrupt elite; the finances of the state oil company are decidedly opaque. Mr Wolfowitz wanted to make full debt relief contingent on a three-year record of anti-corruption efforts, particularly clean audits of the oil company. The Bank's board was sceptical, arguing that Congo qualified under the existing criteria for debt relief and that you could not attach new rules on the fly. After an acrimonious board meeting on February 24th, a compromise was hashed out. Congo would get irrevocable debt relief after "successive annual audit[s]".

Mr Wolfowitz has already cancelled or suspended several tainted loans, some to powerful clients. More than $800m of money for Indian health care is on hold, following evidence of graft in a project on pre-natal health. A $35m loan for building roads in Bangladesh was axed when it became clear that some bids had been rigged. A project to boost Argentina's social safety-net by giving cash to poor households was suspended after Mr Wolfowitz worried that the money was used to buy votes in the 2003 election. A new version of the loan will be debated by the Bank's board this month.

Mr Wolfowitz has also been busy elsewhere in Africa. He has suspended five loans to Kenya, although two others, included one to battle corruption, have gone ahead. Graft in Kenya was also a worry in Mr Wolfensohn's day, causing him to hold back lending there. In January Mr Wolfowitz suspended all loans to Chad when its president tore up an agreement with the Bank designed to ensure that oil revenues would not be misused.

To lead the anti-corruption drive, Mr Wolfowitz has beefed up the Bank's Department of Institutional Integrity, an internal watchdog set up by his predecessor. The unit now has 22 investigators and will get 12 more. Staff have been told to get involved in the preparation of projects rather than simply react to concerns about graft.

Mr Wolfowitz's campaign has had a mixed response. No one doubts that corruption remains an enormous burden on poor countries, despite the Bank's efforts in the past decade. But many development specialists worry that Mr Wolfowitz's approach is both naive and arbitrary.

Corruption, they argue, is a complex and perennial problem. The virtues of rooting out graft need to be balanced against the Bank's goals of helping the poor. "It's just too easy to sit in Washington and say we should be tough on corruption," argues Dennis de Tray, a former Bank director in Indonesia and Central Asia. "In the real world there are many shades of grey".

Mr Wolfowitz's management style has added to the concern. He relies heavily on a small group of advisers he brought with him, none of whom are development experts. Bank insiders complain that the newcomers have no idea how to run the organisation and that their corruption drive is aimed more at impressing America's Congress than at helping the world's poor. Several top veterans have left.

That Bank staff should moan about their boss's style is no surprise. Mr Wolfensohn's relations with his staff were also rocky at first. He brought in a rather larger cadre of outsiders and was notorious for distrusting Bank staff. Top people left and months of paralysis ensued.

It would be a pity if history repeated itself. Mr Wolfowitz is right to focus on corruption, and the task will be hard to get right. No one doubts that better governance is needed to help poor countries grow. For a decade the Bank has sought to promote governance, with reforms from training judges to improving budget processes. But the results have generally been disappointing. Some early fads, such as the creation of anti-corruption commissions, have been mainly ineffective. Overall, graft has not fallen.

If thwarting corruption is to be the Bank's priority, it will need sharper intellectual tools. Many corruption indicators are rankings, based on investors' and experts' perceptions. Some cross-country, objective, cardinal measures, such as how much firms or individuals have to pay in bribes, exist, but more are needed.

Politically too, focusing the Bank primarily on corruption is extremely tricky. As a technocratic body, the Bank is barred from making political judgments. That line has already become blurred, and Mr Wolfowitz's drive will blur it further. A free press, for instance, is a powerful tool against graft. Should the Bank make its lending contingent on greater press freedom? If Mr Wolfowitz is serious about fighting corruption, such questions cannot be ducked—and there will be plenty more controversy ahead.

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Latin American bonds

Kicking the habit

Mar 2nd 2006
From The Economist print edition

At last, the region loses its taste for foreign debt

YOU can safely assume that most Brazilians had more sensuous things on their mind on the last day of *carnaval* than their country's debt. But that didn't stop Standard & Poor's (S&P), a rating agency, creating a little stir of its own on February 28th, when it raised Brazil's foreign debt ratings to two notches below investment grade.

In 2002, Brazil's most recent election year, S&P cut the country's ratings, causing havoc in financial markets. This time, with another election in sight, the markets had hoped for even higher marks. Their bullishness stems from a trend sweeping Latin America, which rating agencies are eager to reward. Across a region scarred by debt crises since independence in the 19th century (see chart), it is now as easy to raise money at home as abroad.

As a result, in the past fortnight Brazil, Mexico, Venezuela and Colombia have said they will retire almost $20 billion of foreign bonds. Brazil and Venezuela are buying back their remaining Brady bonds, a legacy of the wave of defaults in the 1980s that forced Latin American governments to go cap in hand to Nicholas Brady, then America's treasury secretary. At its peak in 1996, Brady debt hit almost $150 billion. By next month, say analysts at J.P. Morgan, only $9.5 billion will be left.

Latin America's stock of foreign debt is still much higher, relative to export earnings, than Asia's or Eastern Europe's. But several factors are helping to end its dependence. Export-led growth, current-account surpluses and a commitment to macroeconomic stability have boosted foreign-exchange coffers to 30-year highs. The growth of private pensions has created a pool of potential lenders at home.

Foreign investors have also noticed the juicy yields on the region's local debt, while spreads on its dollar bonds have hit record lows. For Latin Americans, it looks like a neat reversal of fortune. Once they had to go abroad to borrow; now the foreigners are coming to them to lend.

Might there still be trouble, if one day the foreigners leave in a hurry? The answer may depend on maturity. Mexico, say, should benefit from a five-year head start, an investment-grade rating and a well developed peso-denominated yield curve, stretching to 20 years (it may soon go to 30). Foreigners particularly like Mexico's long-term, fixed-rate paper, making it likelier that they are in for the long haul.

Brazil is different. Its net public debt is still above 50% of GDP, much of it at high, volatile interest rates. S&P has praised it for ending its reliance on dollar-linked debt and scrapping tax restrictions on foreigners keen on local bonds. However, its local debt's average duration is just 14 months, calling for frequent rollovers. According to CreditSights, a research boutique, twice as much domestic debt comes due this year as in the crisis year, 2002. The worry is that in trying to please the rating agencies, Brazil is issuing short-term *real* debt to refinance longer-term dollar debt. That vulnerability should not be overlooked.

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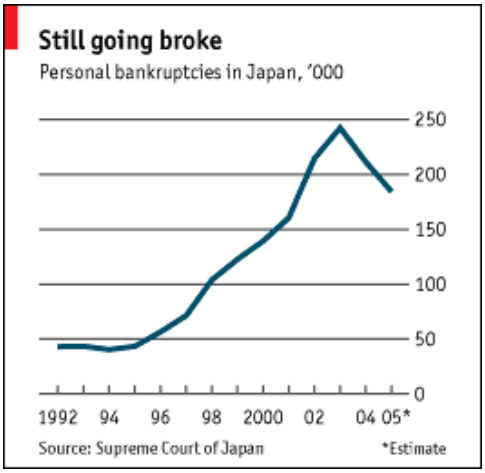
Consumer finance in Japan

Uncertainty bites the moneylenders

Mar 2nd 2006 | TOKYO
From The Economist print edition

These are unusually nervous times for consumer-finance firms

Get article background



JAPAN'S consumer-finance companies have been coining it for decades. They dominate the consumer-lending market, which in other countries is shared between specialised firms as well as banks and credit-card issuers. In recent years, admittedly, the banks and credit-card issuers have made some inroads and the consumer-finance companies' lending has been flat. Even so, Japanese people owe them around ¥12 trillion ($103 billion) all told, ten times the credit-card total.

However, a threat to the consumer lenders' profits is looming: there is a chance that a helpful "grey zone" between two contradictory laws will be closed, or at least narrowed. One of these laws limits interest rates to 15-20%, but with no punishment for offenders; the other caps rates at 29.2%, above which criminal penalties kick in. The average rate charged by the top five consumer-finance firms is a fat 23%, comfortably but not surprisingly in the grey zone. The thousands of smaller companies generally charge more. This being Japan, the lenders' financing costs are extremely low.

The first blow to the grey zone was struck in January, when the Supreme Court ruled in favour of a man who refused to pay his lender a lump sum after he fell behind with his interest payments. The court said that the lump-sum clause in the man's (higher-rate) contract was ambiguous, and therefore invalid, so he need only repay, in instalments, what he owed under the lower-rate law. "Frankly, we were astounded, since these sorts of contracts are standard," says a spokesman for one big consumer-finance company. Lenders will have to write new, clearer contracts, at some cost. Other weak borrowers may also try to exploit the judgment.

Two weeks later, *Nihon Keizai*, a leading newspaper, reported that Japan's financial regulator, the Financial Services Agency (FSA), was planning to revamp the rules governing the consumer-finance industry. The FSA, said the paper, was intending to review or even eliminate the grey zone, in order to reduce the number of personal bankruptcies. As data published last month showed, this has been falling for a couple of years, partly because new, alternative legal procedures are on the rise, but the number remains high (see chart). The regulator was also said to be considering limiting the number of lenders from which an individual could borrow and capping the amount one person could borrow. Another idea was to create a national credit database.

The FSA admits only to being in "friendly talks" with lenders and experts over "issues" in the industry. The most recent of these took place on February 28th. However, consumer-finance firms are only too aware that the 29.2% cap is due for its three-year review in June—and that in 2000 it was cut from 40%. Some commentators think it might be lowered to 25%.

Lenders are likely to resist any further cut if they can; and their generous political contributions will do them little harm. Still, the thought of reform has created consternation in the industry. Tighter rate caps are an obvious cause for concern. And the unification of consumer lenders' jealously guarded proprietorial credit databases into a national whole would remove an important barrier to entry. The biggest new entrants, the banks, have come in mainly by buying stakes in consumer-lending companies, which have an expertise in assessing loan risk that far outstrips their own.

What is bad for the consumer lenders could, despite their market power, be bad for consumers too. Some argue, convincingly, that a crackdown on multiple borrowing and a cut in the maximum interest rate could throw desperate borrowers into the jaws of loan sharks, often in the form of *yakuza*—although the police and legitimate lenders are trying to stifle the unsavoury end of the trade. Investors, though, are already feeling the pain. The prices of shares in the biggest consumer-finance companies are between 6% and 27% lower than they were before the Supreme Court's ruling.

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About sponsorship

European insurance

Waking up the lion of Trieste

Mar 2nd 2006 | MOGLIANO VENETO
From The Economist print edition

Generali's bosses are shaking up the Italian insurer's complacent culture

AFP

"WE USED to be a sum of companies," says Sergio Balbinot, one of Generali's two chief executives. Now, he implies, Italy's biggest insurer, symbolised since 1848 by the winged lion of St Mark, is a unified whole. Under Generali's first strategic three-year plan, announced in January 2003, Mr Balbinot and Giovanni Perissinotto, his co-boss, have made the insurer from Trieste a more coherent group, with better co-ordination among its national subsidiaries. On March 6th the men at the top will announce to investors a second set of performance and profit targets, covering the next three years.

They still have some way to go. Generali's performance lags behind that of its European peers. Its market capitalisation of €38 billion ($45 billion) is much lower than those of France's AXA and Germany's Allianz, both around €55 billion. Despite Mr Balbinot's and Mr Perissinotto's efforts, since 2003 Generali's share price has not matched the Dow Jones index of insurers' shares. Its return on embedded value, an insurance-industry measure that includes future profits from policies already on the books, is about 12%. Its rivals can boast 14-16%.

When Generali's top team took over in 2002 their most urgent task was to clean up the mess at INA, an Italian insurer bought in 1999. Mr Perissinotto, who is in charge of Generali's home market, fired one-third of INA's workforce, sold its grand offices in Rome to the American ambassador, cancelled half of the risky business INA had taken on and redirected the company towards retail business. He denies that the unhappy €12 billion purchase had been made under pressure from Mediobanca, a powerful Milanese investment bank and Generali's biggest shareholder with 14%.

Heads had to roll in local fiefs, often after bitter battles. The bosses of Generali's operations in Spain, France and Austria and the top dogs at INA and Alleanza, another Italian subsidiary, were fired. They were replaced by strong new managers, such as Claude Tendil, the boss of Generali's operations in France, who has nearly doubled the French subsidiary's premium income since 2002. France now contributes 21% of Generali's premium income. By the end of this year some 3,000 people will have been made redundant since the new regime took charge. In addition, the salesforce has had to change its ways. It was told it should go after high-margin business rather than volume and would be rewarded accordingly. "They didn't like this at all because it is much harder," says Mr Perissinotto.

Having fixed these problems, the insurer's bosses have about a year to convince investors that they can speed up the group's restructuring and lift its lagging share price. Next year the top management's term in office is up for renewal. The shareholder pact in control of 55% of Mediobanca is expiring. UniCredit, a big bank that is one of Mediobanca's main shareholders, wants to sell the stake in Generali if the insurer's performance doesn't improve. And new European rules on insurers' solvency will kick in. Among many other things, these will clarify whether AXA or Allianz has the clout to buy a company of Generali's size.

The European game

Rumours about a merger of AXA and Generali have been around for years. Quite a few analysts think they would make a good fit, but Generali's bosses say they underwrite dissimilar types of risk and have a different mentality. AXA is run more aggressively than Generali is. It takes on greater risks, such as big natural catastrophes, and invests a higher proportion of its assets in equities. Generali parks most of its cash in safer but less lucrative fixed-income securities. Moreover, say Generali's people, pooling too much risk in a single European institution could pose a danger to the system.

In its new strategic plan Generali is likely to explain how to make better use of its cash pile. It has €1.7 billion in excess capital on its balance sheet and €1.3 billion in subordinated debt. This war chest could be used to buy out minorities in AMB, its German subsidiary, and for further expansion in central Europe and Asia. Generali will probably also say that it will keep on cutting costs and streamlining operations, especially in Italy. Nicolas Schwartzmann, of Exane BNP Paribas, a French broker, estimates that further restructuring could lift Generali's normalised earnings by 14% compared with 4% at AXA, which has done most of the hard work.

Generali has come a long way over the past three years. The group's combined ratio (claims plus expenses, divided by premiums) is down to below 100%, from 108%. "We have gained credibility, but this is tough being Italian," jokes Mr Perissinotto. In the near future he wants the insurer to become less Italian—both in its geographical spread and in the eyes of those investors who still cling to cultural stereotypes.

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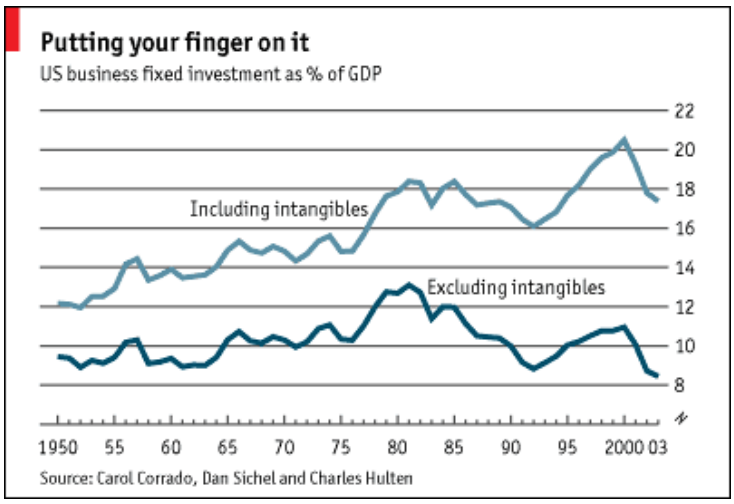
About sponsorship

Economics focus

Getting a grip on prosperity

Mar 2nd 2006
From The Economist print edition

What changes if intangible investment is measured properly?



ARGUING that America is ill served by its economic statistics has become fashionable. Stodgy old national-income accounts are said to do a poor job of measuring the modern "knowledge" economy. They are especially bad at picking up firms' "intangible" investments, such as building brands or training staff. Measure this spending properly, the argument runs, and America's true economic health would be revealed. Investment and output growth would be higher; the pesky external deficit would be lower. As *Business Week* put it recently, the "unmasked" American economy is "a lot stronger than you think".

Really? It would certainly be convenient if America's much-vaunted macroeconomic weaknesses (a falling saving rate, over-reliance on foreign borrowing to finance consumption) were mere statistical mirages. Unfortunately, things are not so simple. Although measuring intangibles does change the picture of America's economy, it does not necessarily improve it.

Under today's international system of national-income accounting, overall investment includes firms' spending on fixed capital (such as factories or computers), additions to inventories, and expenditure on residential and commercial property. Spending on research or organisational improvements, in contrast, is not counted as investment but as spending on current inputs. Because national accounts are calculated on a value-added basis, it drops out of overall GDP. Granted, official statistics are evolving. Many countries now class expenditure on software as investment. Statistical agencies are also discussing the capitalisation of research and development spending. But other intangible investment goes uncounted.

The intangible mask

Few economists doubt that boosting a brand can be an investment, just as building a factory is: conceptually, investment is simply spending today that yields a stream of income in the future. The problem is practical. Intangible investment is often hard to identify, let alone value. How much of an advertising campaign is part of the cost of selling a product (and thus current spending) and how much is investment in a brand?

In recent research* Carol Corrado and Dan Sichel, of the Federal Reserve, and Charles Hulten, of the University of Maryland, have tried to estimate the scale of intangible investments in America. The authors look at spending on all manner of things, from developing copyrights to tuition payments for job-related training. Often they are forced to make heroic assumptions, guessing, for instance, that managers spend 20% of their time on organisational innovation (an investment) and the rest running their firms. Given such guesswork, the results should not be taken too precisely. But they are striking nonetheless.

The authors find that the pace of intangible investment by American firms has risen sharply in recent decades: by the late 1990s, it was around $1 trillion a year, about the same as expenditure on traditional fixed assets. According to today's official statistics, America's investment rate has been pretty flat since the 1950s. Count intangibles, and it has been rising steadily (see chart). In the 1950s the inclusion of intangible investments would have raised GDP by 5%. In recent years it would have lifted it by 12%. Using yet more assumptions (this time about depreciation rates), the authors reckon that excluding intangibles may understate America's capital stock by $3.6 trillion. Even if this is only roughly right, intangibles seem too big to ignore.

Thanks to higher investment, including intangibles pushes up productivity growth too—although it does not explain the acceleration of productivity after 1995. Capitalising intangible spending raises average productivity growth between 1973-95 by more than it does for the years since then.

A striking shift occurs between labour and capital. Official statistics say that workers' share of national income has been fairly flat for decades. Capitalising intangible investment increases capital's slice and reduces labour's, with a particularly sharp drop after 1980. If intangibles are included, labour's share today drops from 70% to 60%.

If investment is higher than today's statistics suggest, so, automatically, is saving. With firms' current spending lower and profits fatter, corporate saving (and so national saving) must be higher. It follows that the capitalisation of intangibles alone does not affect America's external deficit, which is the difference between what the country saves and what it invests.

Not exactly, argue some knowledge-economy optimists. First, they claim, ignoring intangibles affects America's external accounts directly. Were intangibles measured properly, the current-account deficit might be smaller, since America exports lots of managerial know-how and other intangible assets. Two Harvard economists recently labelled these and other uncounted exports “dark matter”. To most other economists, however, this argument is thin. Even if intangible exports were counted explicitly (rather than as part of firms' profits on foreign operations), they would not alter the overall reliance on foreign funds.

The optimists' second argument is that the reliance on foreign capital may be real, but it is less worrisome. Borrowing to boost skills or research is quite different from borrowing to fuel a consumption binge. Close examination of Ms Corrado's, Mr Sichel's and Mr Hulten's estimates casts doubt on this too. Their numbers suggest that intangible investment slowed sharply after 2000, the year the stockmarket bubble burst—as America's current-account deficit soared. Foreigners may have been funding intangible investment in the roaring 1990s, but not since. A more accurate measure of the information economy is certainly worth having, but it does not make America any less profligate.

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* “Intangible Capital and Economic Growth”. NBER working paper no 11948, January 2006: papers.nber.org/tmp/16760-w11948.pdf.

“Measuring Capital and Technology: An Expanded Framework”. Federal Reserve, August 2004: http://www.federalreserve.gov/pubs/feds/2004/200465/200465pap.pdf

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Marjorie Deane internship

Mar 2nd 2006
From The Economist print edition

Applications are invited for the 2006 Marjorie Deane internship. This award, financed by the Marjorie Deane Foundation, is designed to provide work experience for a promising journalist or would-be journalist, who will spend three months of the summer at *The Economist*, writing about finance. Applicants may also be considered, if they wish, for an internship of similar duration at *CFO Europe*, a sister publication of *The Economist*. Applicants should send a letter introducing themselves, with an original article of about 1,000 words that they think would be suitable for the finance and economics section of *The Economist*. Applications must reach us by March 31st. They should be e-mailed to deaneintern@economist.com or posted to the Business Affairs Editor (Deane internship), The Economist, 25 St James's Street, London, SW1A 1HG.

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Tuberculosis

Reality check

Mar 3rd 2006
From The Economist print edition

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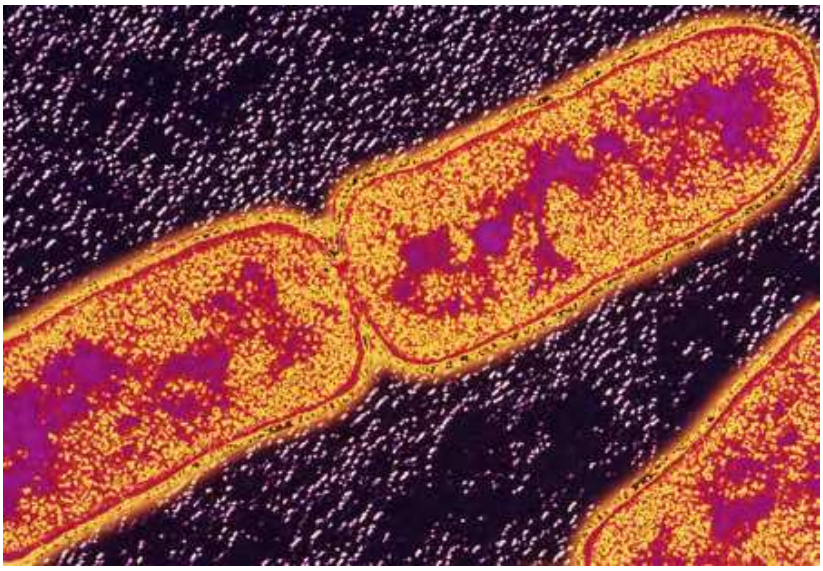

The road to a new drug for tuberculosis may be longer than some people hope

TUBERCULOSIS is the disease that will not go away. For about a century after 1882, the year that Robert Koch identified the bacterium (pictured above) which causes TB, infection rates dropped as drugs were developed and vaccination programmes rolled out. But once TB was eliminated from the rich world, interest waned. No new drug has been developed in the past 40 years, and the existing treatment regime takes six to nine months to clear the bacteria from a patient's body. Indeed, the past two decades have seen TB's resurgence in poor countries—in particular as an opportunistic infection in those whose immune systems have been damaged by HIV. Some 2m people a year now die of the infection.

New drugs, it is widely agreed, are needed. And many are now being shepherded through the tedious process of research and development by the Global Alliance for TB Drug Development, a six-year-old venture based in New York which acts as a dating agency for companies, governments and academic institutions that would like to collaborate in developing such drugs.

On the face of it, the alliance is a success. Partly under its aegis, 27 potential anti-TB drugs are at various points along the pipeline that leads from a promising molecule to a medicine that doctors can prescribe. The aim is to have at least one of these molecules complete the journey by 2010. But a group of medical economists led by Kevin Schulman, of Duke University in North Carolina, doubts the feasibility of this goal. And they explain the reasons for their disbelief in a paper in this week's *Science*.

TB or not TB

Public-private partnerships of the sort the alliance encourages are supposed to bring, among other advantages, a realistic appraisal of the chance of success. Dr Schulman and his colleagues have taken this idea at face value, and treated the TB-drug programme—which is, admittedly, being run by several different groups—as though it were the project of a single drug company. They have then applied a test called a portfolio model to the process.

Such models, which are widely used in the pharmaceutical industry, take inputs such as the costs of clinical trials, the length of each stage of drug development and the probability of success at each stage. They convert these into the expected number of successful molecules, the expected costs at each stage of development, and the total cost of the process taking into account both successful and rejected molecules. Add in the effects of chance (what is known as the Monte Carlo simulation method), and you end up with what should be a plausible range of timescales

and costs.

Applied to the TB portfolio, the result does not look good. Even extending the timescale to 2019, the model suggests there is only a 73% chance that a successful drug will emerge. By the 2010 deadline the alliance has set itself, the chance of success is estimated at less than 5%.

Dr Schulman and his colleagues then started tinkering with the inputs to try to find out how easily this state of affairs could be improved. Clinical trials on people are conventionally divided into three phases, each more rigorous and wide-ranging than its predecessor. The real state of the world is that five anti-TB molecules are in phase I trials and two are in phase II. The researchers magically doubled these numbers and found that the chance of success by 2019 went up to 93%, but success by 2010 remained less than 5% probable.

This is, of course, only a model. And the alliance counters its specific criticism—that its 2010 target is unrealistic—by pointing to a particular drug that it hopes might enable it to meet that target. This drug is moxifloxacin. It is made by Bayer and its advantage is that it is already widely used against bronchitis, so it is known to be safe. Tests on mice suggest it will also work against TB, and might reduce the length of treatment by two to three months, which would be a useful gain.

Whether moxifloxacin will fulfil its promise remains to be seen. Dr Schulman's model, though, has cost as a second element, which should certainly help the alliance with its planning. The upshot, according to the model's calculations, is that to have a reasonable chance of producing a successful drug, about $400m will have to be committed to the research.

Raising that sum is by no means out of the question. The Bill & Melinda Gates Foundation, for example, plans to make $900m available for TB eradication over the next ten years, and some of that will surely come the alliance's way. Moreover, after years in the wilderness, overshadowed by the more fashionable diseases of AIDS and malaria, there seems to be a resurgence of interest in dealing with TB. A realistic appraisal of the task ahead is therefore timely, and a businesslike approach is the one most likely to succeed.

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Immunology

Gold fingered

Mar 2nd 2006
From The Economist print edition

An unexpected discovery may help explain how old arthritis drugs work

JOURNALISTS wishing to hype a medical discovery often reach for the cliché "silver bullet". Well, here is a story where the bullets are made of gold and platinum, as well.

Those bullets' targets are a range of ailments known as autoimmune diseases. These diseases, which include juvenile diabetes, lupus and rheumatoid arthritis, are the result of the body's immune system turning on its host. Instead of recognising and attacking foreign objects, it recognises and attacks its owner's own cells. Such diseases are hard to treat and there is, as a consequence, a need to find new drugs that will suppress the parts of the immune system that generate this unwanted response—and, as he writes in *Nature Chemical Biology*, Brian DeDecker, a cell biologist at Harvard Medical School, thinks he may have a clue to the answer.

Dr DeDecker and his colleagues have been searching for many years for drugs that will disrupt the activity of molecules called MHC class II proteins. The immune system works using special "antigen-presenting" cells armed with these proteins to present pieces of an invading bacterium or virus on their surfaces to other cells known as lymphocytes. This presentation tells the lymphocytes what they should be looking for, rather in the way that allowing a bloodhound to smell a piece of clothing lets it track a suspect. In those with autoimmune diseases something goes wrong with the recognition system and the lymphocytes start seeking out and destroying the wrong cells, so it is reasonable to suspect that MHC class II proteins might be implicated.

During the course of their search, Dr DeDecker and his team have screened some 30,000 chemical compounds in the hope of finding something that might adversely affect the proteins in question, without much success. But that was before they decided to screen a group of drugs that had recently been approved for other purposes. Two of these drugs worked, and they had a surprising element in common: platinum.

Initially Dr DeDecker was less than pleased. "We were looking for a fancy, complex organic molecule and found something simple instead," he explains. But he soon rallied. The group then went on to discover that it was not just platinum that disrupted the work of the MHC class II proteins. The whole class of noble metals (so called because they are snobbishly unreactive with other elements) behaved in this way. In particular, Dr DeDecker found that besides platinum, palladium and gold worked especially well. The researchers still do not understand completely how these metals disrupt MHC class II proteins, but the speed with which that disruption happens suggests that the metal atoms are actively knocking crucial pieces of the system out.

Intriguingly, this study shines light on the use of gold-based drugs for the treatment of rheumatoid arthritis and other autoimmune diseases. These have been employed since the 1930s, although they take months to work and sometimes have severe side-effects. Until now, nobody has understood how these drugs work. But knowing that MHC class II proteins are disrupted by noble metals suggests new avenues for developing and improving upon these old arthritis drugs.

More speculatively, the study might explain why wearers of gold rings sometimes report a delay in the progression of rheumatoid arthritis in their ring fingers compared with their other fingers. Dr DeDecker is not sure. He says that, so far, the group has found only a particular highly oxidised form of gold that works. The gold in a ring is unoxidised metal, and transmuting it into the oxidised form would require it to deign to participate in some chemical reactions. The research also says nothing about whether there is any basis for the use of copper bracelets to relieve the symptoms of arthritis. Copper, although in the same group of the periodic table as gold, is too chemically friendly with other elements to count as a noble.

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Invasive species

Go forth and multiply

Mar 2nd 2006
From The Economist print edition

Invasive plant species have different chemistry from their neighbours

WHAT makes for a successful invasion? Often, the answer is to have better weapons than the enemy. And, as it is with people, so it is with plants—at least, that is the conclusion of a paper published in *Biology Letters* by Naomi Cappuccino, of Carleton University, and Thor Arnason, of the University of Ottawa, both in Canada.

The phenomenon of alien species popping up in unexpected parts of the world has grown over the past few decades as people and goods become more mobile and plant seeds and animal larvae have hitched along for the ride. Most such aliens blend into the ecosystem in which they arrive without too much fuss. (Indeed, many probably fail to establish themselves at all—but those failures, of course, are never noticed.) Occasionally, though, something goes bananas and starts trying to take the place over, and an invasive species is born. Dr Cappuccino and Dr Arnason asked themselves why.

One hypothesis is that aliens leave their predators behind. Since the predators in their new homelands are not adapted to exploit them, they are able to reproduce unchecked. That is a nice idea, but it does not explain why only certain aliens become invasive. Dr Cappuccino and Dr Arnason suspected this might be because native predators are sometimes "pre-adapted" to the aliens' defences, but in other cases they are not.

To test this, they had first to establish a reliable list of invaders. That is not as easy as it sounds. As they observe, "although there are many lists of invasive species published by governmental agencies, inclusion of a given species in the lists may not be entirely free of political motivation". Instead, they polled established researchers in the field of alien species, asking each to list ten invasive species and, for comparison, ten aliens that just rubbed along quietly with their neighbours. The result was a list of 21 species widely agreed to be invasive and, for comparison, 18 non-invasive aliens.

Having established these lists, they went to the library to find out what was known about the plants' chemistry. Their aim was to find the most prominent chemical weapon in each plant, whether that weapon was directed against insects that might want to eat the plant, bacteria and fungi that might want to infect it, or other plants that might compete for space, water, nutrients and light. Botanists know a lot about which sorts of compounds have what roles, so classifying constituent chemicals in this way was not too hard.

The researchers then compared the chemical arsenals of their aliens with those of native North American plants, to see if superior (or, at least, unusual) weaponry was the explanation for the invaders' success. Their hypothesis was that highly invasive species would have chemical weapons not found in native plants, and which pests, parasites and other plants would therefore not have evolved any resistance to. The more benign aliens, by contrast, were predicted to have arsenals also found in at least some native species.

And so it proved. More than 40% of the invasive species had a chemical unknown to native plants; just over 10% of the non-invasive aliens had such a chemical. Moreover, when they looked at past studies on alien plants that had examined how much such plants suffer from the depredations of herbivorous insects, they found that the extent of the damage reported was significantly correlated with the number of native species with which that alien shared its principal chemical weapon.

For alien plants, then, the real secret of success—also as in human warfare—is surprise. It is not that the chemicals concerned are more toxic in any general sense (indeed, successful invaders are often rare in their own native habitats). Rather, it is that the locals just don't see them coming.

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Sexual selection

Facing the truth

Mar 2nd 2006
From The Economist print edition

Are rugged good looks really more attractive?

OKAY girls. 'Fess up. Do you prefer rugged, testosterone-fuelled good looks in a man, or more sensitive facial features? And why? A thousand women's magazines have blazed a trail in asking that question, but evolutionary biologists are now treading cautiously in their wake.

The latest group to tiptoe into the minefield is led by Lisa DeBruine, of the University of St Andrews, in Scotland. She and her colleagues have attempted to reconcile the sometimes conflicting results obtained by previous researchers in a paper just published in the *Proceedings of the Royal Society*.

It is well established that facial features rated as masculine (square-jawed, rugged, that sort of thing) are the result of high testosterone levels. There is a good evolutionary reason why such features should be attractive, and it is that such faces also indicate a strong immune system.

One of the unfortunate side-effects of being male is a higher death rate, at any given age, than if you are female. Part of the cause of this is that testosterone suppresses the immune system, leaving high-testosterone individuals particularly vulnerable to infection. So a man who has made it to sexual maturity despite his high testosterone levels probably has a particularly good immune system, which he can pass on to his children.

That is the good news. The bad news is that a man with high testosterone is more likely to love you and leave you, so you might want to settle for Mr Nice-guy and his more effeminate features. Not surprisingly, then, the data are equivocal about which sort of face women prefer.

The problem that Dr DeBruine spotted is that this equivocation might be real—with different women pursuing, albeit unconsciously, different reproductive strategies—or it might be an artefact of the way the experiments have been conducted. These sorts of studies usually rely on photographs that have been manipulated to make the faces in them look either more masculine, or less so. Since different groups of researchers have hit on different methods of manipulation, it might be that the women involved in the experiments are reacting to something about the methods in a way that is different from their reaction to real faces.

Dr DeBruine and her colleagues identified three manipulation methods. One works by extrapolating the shape differences between average men's and women's faces and morphing a man's face accordingly. Another uses a range of faces, independently rated for masculinity, as its starting point, and also allows a role for colour as well as shape. The third relies on tracking the way men's faces actually do change through puberty. Using the same basic faces, the team generated six versions of each—a masculinised and a feminised pair for each of the three manipulation methods.

What they found was that the manipulation method made no difference. Women really do vary in the degree of masculinity they prefer. Good news for wimps, then. Moreover, Dr DeBruine found that women's preferences as measured by the test agreed closely with the perceived degree of masculinity of the real-life partners of those who were in stable relationships. Every pot, as the proverb has it, finds its cover.

But it is not all bad news for the hyper-masculine. Past research has suggested that, regardless of their average preferences, women are most attracted to hyper-masculine features when they are most likely to conceive, and that the effect is particularly exaggerated in women who are in stable relationships. Evolution has thus arranged things so that if a woman does cuckold her man, she is likely to gain the maximum advantage in terms of children with good immune systems, and sons who will have similarly rakish good looks and behaviour. Just don't tell your husband that.

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Climate change

Cold comfort

Mar 2nd 2006
From The Economist print edition

Would global warming have been dealt with more decisively if man had been a temperate creature rather than a tropical one?

Get article background

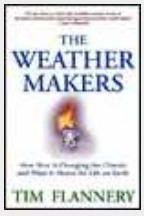
AVOIDING climate change is like avoiding getting fat. That one extra biscuit won't make much difference, but once the kilos are on it is hard to get them off. Both "The Weather Makers" and "Field Notes from a Catastrophe" make an analogous point—that global warming is a process that is hard to reverse. Climate change is more visible at the poles than elsewhere, for example, because ice is one of the best reflectors of sunlight, and water is one of the worst. Melt the ice and the balance between heat sent packing straight back into space and heat retained to warm the planet shifts very fast.

In his book, Tim Flannery, a zoologist, delves into the science of climate change. He is at his angriest when writing about the extinction of species and habitats that rapid global warming is likely to bring about. Elizabeth Kolbert, who writes for the *New Yorker*, by no means eschews the science, but her emphasis is on her discussions with people who work in the field, and much of her writing is anecdotal.

Both books trumpet the same central message: act now. Every year's delay in doing something about climate change will take far more than a year to put right. Once the ice is gone, it will not come back. Once the permafrost melts and the methane it contains is released, it cannot be recalled—and methane is a far more potent greenhouse gas than carbon dioxide. In addition, Mr Flannery comes from Australia, Ms Kolbert from America; the only industrialised countries that have failed to ratify the Kyoto protocol on climate change. Although the protocol is certainly a flawed document, both authors regard agreeing to it as a sign of a government's good faith in the matter of greenhouse-gas emissions, and both excoriate what they regard as the weasel words of their respective administrations about acting on the issue independently of Kyoto.

In this respect, Ms Kolbert wins out over Mr Flannery. Her report of her interview

The Weather Makers: How Man is Changing the Climate and What it Means for Life on Earth
By Tim Flannery



Atlantic Monthly Press; 384 pages; $24.
Penguin/Allen Lane; £20

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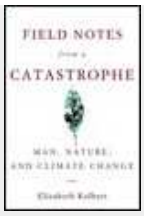
Field Notes from a Catastrophe: Man, Nature, and Climate Change
By Elizabeth Kolbert

with Paula Dobriansky, who has the job of explaining the American administration's position on global warming, is a masterpiece of verbal juggling. When it comes to prescriptions, though, Mr Flannery's analysis has the edge. He mercilessly dissects the alternatives—particularly the idea of replacing hydrocarbon fuels with hydrogen, which he regards as expensive and probably technically unfeasible. And he dismisses the hydrogen-economists' idea of "sequestering" the carbon dioxide generated underground or in the oceans as both impractical and environmentally catastrophic.

The answer, according to Mr Flannery, lies in revamping the way electricity is generated. That means abandoning coal, the most carbon-intensive fuel around, and employing sunlight, wind, geothermal power (which he believes is an under-appreciated resource) and also nuclear power. Having done that, the problem of dealing with petroleum-consuming transport becomes one of storing electrical energy in a sufficiently dense form that vehicles can use it. Here, he thinks, hybrid petrol/electric cars point the way forward.



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Mr Flannery's most intriguing thought, though, is almost a throwaway point. But it is one that only an evolutionary biologist would have come up with. He suggests that if humanity were facing the threat of cold, rather than heat, the talking would have been over long ago and a strong plan of action would be in place. His point is that *Homo sapiens* is a tropical species which, having only recently spread to temperate and frigid climes, still thinks like a tropical species. It really fears the cold, but rather likes the heat. The word "warming", therefore, has positive overtones. So perhaps the underlying problem is not so much, as in the case of staying slim, that you have to trade a real sacrifice now for a potential benefit in the future, but that a lot of people who are perfectly willing to believe that global warming is happening don't really see it is a problem at all.

The Weather Makers: How Man is Changing the Climate and What it Means for Life on Earth.
By Tim Flannery.
Atlantic Monthly Press; 384 pages; $24. Penguin/Allen Lane; £20

Field Notes from a Catastrophe: Man, Nature, and Climate Change.
By Elizabeth Kolbert.
Bloomsbury; 210 pages; $22.95. To be published in Britain by Bloomsbury in June

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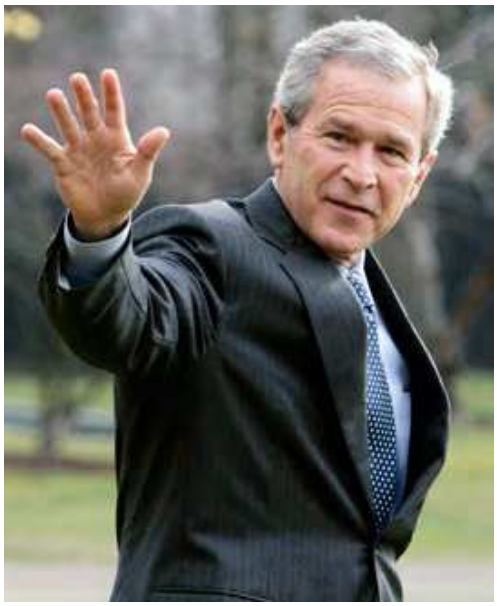
George Bush

Fake conservative

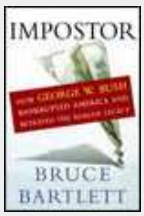
Mar 2nd 2006
From The Economist print edition

Reuters



Not with the right

Impostor: How George W. Bush Bankrupted America and Betrayed the Reagan Legacy
By Bruce Bartlett



Doubleday; 310 pages; $26

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HELL hath no fury like a disillusioned ideologue. That may be the only conclusion to draw from this latest anti-George Bush screed. Entire bookshelves already stand testament to the president's knack for driving left-leaning American writers into a frenzy. "Impostor" shows that right-wingers are just as prone to the same condition.

Bruce Bartlett is a card-carrying Reaganite libertarian. He truly believes in free markets, small government and low taxes. His 1981 book "Reaganomics" was a manifesto for its era. He worked in the Reagan White House and the Treasury Department of Mr Bush's father. Until he was sacked last autumn (for writing this book), Mr Bartlett was attached to the National Centre for Policy Analysis, a Dallas-based think-tank which propounds free-market solutions for everything from health care to pension reform. His conservative credentials, in short, are beyond question.

Which is more than he can say for the man in the White House. Mr Bartlett accuses Mr Bush of being a "pretend conservative", who betrayed the conservative cause for short-term electoral gain. Far from being the Gipper's heir, Mr Bartlett compares Mr Bush to Richard Nixon, another man who was more concerned with vote-buying than political conviction.

From steel tariffs to spiralling regulation and profligate spending, Mr Bartlett tears into every aspect of Mr Bush's economic policy. Page after page denounces the administration's lack of principle, the president's lack of interest in the policy process, and the White House's general ineptitude. This book is a sobering reminder of just how much the Bush team has got wrong: from the failure to veto a single spending bill, however pork-laden, to the crass recklessness of serially cutting taxes while introducing the biggest expansion of a government entitlement programme in decades—the inclusion of prescription-drug coverage in Medicare, the government health plan for the elderly.

That recklessness, Mr Bartlett argues with a candour that few other conservatives can muster, will inevitably lead to higher taxes. He dismisses the idea, still peddled by some Republicans, that cutting taxes will "starve the beast" of government and lead to lower spending. Instead, he predicts that Mr Bush, or his successor, will be forced to raise taxes, and even suggests that introducing a value-added-tax would be the best way to do it. Though it is unlikely to win him many conservative friends, Mr Bartlett's analysis of America's fiscal prospects is compelling.

Unfortunately, his overall indictment of the president is less compelling than it should be. That is mainly because, like many other Bush-bashing authors, Mr Bartlett is too often driven to hyperbole. He suggests, for instance, that Mr Bush "may be the most protectionist president" since Herbert Hoover, thanks to the imposition of temporary steel tariffs in 2002 and the increase in farm subsidies. That is nonsense. Nixon, who imposed an across-the-board import surcharge in 1971, was more protectionist than Mr Bush. So, too, was Mr Bartlett's hero, the Gipper. For all his free-trade rhetoric, Reagan introduced far more "voluntary" trade restrictions—on cars, semiconductors and machine-tools—than Mr Bush has ever done. Given the current level of sinophobia in Congress, the Bush team has, so far, stood remarkably firm in defence of free trade.

A more nuanced analysis might not have pleased Mr Bartlett's publishers, but it would have resulted in a better

book. The bookshops are already full of shrill indictments of Bushonomics. Unfortunately, "Impostor" only adds to their ranks without adding much to knowledge.

Impostor: How George W. Bush Bankrupted America and Betrayed the Reagan Legacy.
By Bruce Bartlett.
Doubleday; 310 pages; $26

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New thrillers

Local hero

Mar 2nd 2006
From The Economist print edition

ESPIONAGE thrillers look simple to cook up—international politics, shadowy spy agencies, super-fit heroes and athletic sex offer an easy recipe—but few authors get anything close to providing a gourmet meal. Fewer still can create characters that endure and develop from book to book, and avoid the ghetto of a single arena of national or regional intrigue. One that increasingly looks like bucking the trend is Barry Eisler.

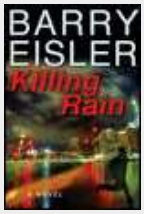
The first two books that featured Mr Eisler's Japanese-American assassin-hero, John Rain, "Rain Fall" (2002) and "Hard Rain" (2003) were written with a delightfully soft touch and a powerful blend of excitement, exotica and what (ever since John le Carré) readers have known to call tradecraft. But they were likely to appeal mostly to those who know or are intrigued by Japan, for that is where they were based.

With two leaps, however, Mr Eisler has broken free. In "Rain Storm" (2004) both the hero and the villains discovered globalisation. The action moved to South-East Asia, Hong Kong and Brazil, while the protagonists broadened to encompass Mossad, al-Qaeda, arms dealers and sundry shady Saudis, as well of course as the CIA. And now in "Killing Rain" the dramatis personae are similarly broad, while the main locations are Hong Kong and the Philippines. Few readers will be able to visit the men's toilets in Hong Kong's China Club without a nervous backwards glance at the maintenance door, from behind which Mr Rain emerges for one of his killings.

Mr Eisler has managed to pull off two further tricks, in addition to escaping the Japanese trap. One is to make the tradecraft convincing rather than simply gadget-ridden or exotic, and to make the organisations and people practising it feel believable. In this he has an advantage: just as Mr le Carré spent some time in Britain's MI6, so Mr Eisler served for three years in the CIA. The second trick is to make his hero's thoughts almost as interesting as his actions, thus providing a more balanced and satisfying read: Mr Rain is a paid killer with a conscience, always questioning his own motives and morals, trying to work out which are the good guys and which the bad, so that he is on the right side. He is also increasingly preoccupied with retirement, which means eluding all the agencies he has worked for or against. This reviewer, at least, hopes that Mr Rain will put off quitting for a while.

Killing Rain.
By Barry Eisler.
Putnam; 352 pages; $24.95. Published in Britain as "One Last Kill" by Michael Joseph; £12.99

Killing Rain
By Barry Eisler



Putnam; 352 pages; $24.95. Published in Britain as "One Last Kill" by Michael Joseph; £12.99

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Science of the mind

Proustian moments

Mar 2nd 2006
From The Economist print edition

WHEN Eric Kandel was a boy, his family's home in Vienna was ransacked by the Nazi police. Nearly 70 years later, he can replay the entire scene in his mind, down to the toy car he was playing with when he heard the banging on the front door. Dr Kandel begins his memoir with this story because his family's flight from Austria to America was such a decisive event in his life. But he also uses it to illustrate how the vividness of memory is itself a wondrous thing. By what magic, he asks, can sound waves from a banging door leave a mark on a boy's brain that persists for decades?

Dr Kandel's life's work has been to try and learn how events are recorded in the brain: the biological basis of "never forget". Half-autobiography, half a popular account of advances in neuroscience, "In Search of Memory", his new book, tells the story of his research and how it led to the Nobel prize for medicine in 2000.

True to his Viennese roots, Dr Kandel began by reading Freud; with youthful zeal he resolved to find the anatomical location of the id and ego. An early mentor suggested that this was perhaps unrealistic. It would be more productive to start small, and study individual brain cells. Dr Kandel found the ideal research subject in the Aplysia marine snail, which is simple enough for its nerve cells to be examined one by one, yet complex enough to have memories. For example, a snail can be taught that an experimenter poking its gill is not a threat (or, in a crueller version of the experiment, that an electric shock will soon follow).

By sticking an electrode into each nerve cell, Dr Kandel and his colleagues eavesdropped on the electrical signals that accompany snailish thoughts. They created a "wiring diagram" for the snail's nervous system, showing how each neuron was linked to the others. Then they worked out the chain of chemical reactions that begins with a sensory perception and ends with long-term changes in a particular circuit of neurons: a memory.

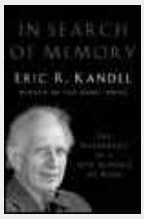
The bigger question is whether or not these insights apply to more complicated creatures. Here much work still needs to be done, but the broad answer appears to be yes. It is astonishing to learn that events of years gone by are encoded in the brain in a pattern of electrical and chemical connections, but the technical details can still be confusing. Serotonin begets cyclic AMP, which begets protein kinase A, and so forth. Dr Kandel delves into those details, but he returns to the big picture just often enough to engage the non-scientist. As he sees it, neuroscience is the long-sought bridge between the humanities and the sciences. He still harbours the hope that psychiatry will be put on a firm scientific basis, and he argues that other humanistic fields, such as ethics and sociology, will also benefit from brain studies.

The weaving of science and memoir, in a clear and unadorned style, is especially effective in the first half of the book. In the latter half, long sections on the biotechnology industry and on Austrian anti-Semitism break up the chronology, and the book becomes harder to follow.

Perhaps this problem relates to the useful ability of memory to prune away the chaotic branches of experience. The earlier the time period, the easier it is to perceive as a singular narrative. No doubt an excellent research topic for one of Dr Kandel's energetic scientific heirs.

In Search of Memory: The Emergence of a New Science of Mind.
By Eric R. Kandel.
Norton; 510 pages; $27.95

In Search of Memory: The Emergence of a New Science of Mind
By Eric R. Kandel



Norton; 510 pages; $27.95

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Amazon worldwide bestselling fiction

The big book index

Mar 2nd 2006
From The Economist print edition

The globalisation of Harry Potter and other delights

OLD one-off favourites, such as "The Da Vinci Code" and "The Kite Runner", sit alongside new instalments by popular authors—Stephen King, James Patterson, Laurell K. Hamilton and Cecelia Ahern—proving that it takes time to climb the ladder, but once you are made as a writer, it's marketing all the way.

1. Harih Pottah To Nazono Purinsu (Harry Potter and the Half-Blood Prince).
By J.K. Rowling. Translated by Yuko Matsuoka. *Say-zan-sha; 600 pages; ¥3,990*

Millions of Japanese children have been saving up for months to buy the latest instalment of their favourite hero in their native language, which recasts HPHBP as Harih Pottah and the "mysterious prince".

Click to buy from Amazon.co.jp

2. Night.
By Elie Wiesel. *Hill and Wang; 144 pages; $5.40*

An autobiographical novella featuring a young Jewish boy in a Nazi death camp who over time witnesses the loss of his family, his innocence and his god.

Click to buy from Amazon.com or Amazon.co.uk

3. Cell.
By Stephen King. *Scribner; 384 pages; $16.75. Hodder & Stoughton; £9.88*

A homage to zombie films that will please fans of the gorier side of the king of horror no end.

Click to buy from Amazon.com or Amazon.co.uk

4. The 5th Horseman.
By James Patterson and Maxine Paetro. *Little, Brown; 400 pages; $16.77. Headline; £10.78*

The Women's Murder Club pays homage to Michael Crichton as it heads for the hospital—and then the courtroom.

Click to buy from Amazon.com or Amazon.co.uk

5. Labyrinth.
By Kate Mosse. *Putnam; 720 pages; $17.13. Orion; £3.99*

A new quest for the Holy Grail in France by the founder of the Orange prize for fiction, given a sales boost by Britain's Oprah, the Richard & Judy book club.

Click to buy from Amazon.com or Amazon.co.uk

6. The Time Traveler's Wife.
By Audrey Niffenegger. *Harvest Books; 560 pages; $11.20. Vintage; £3.99*

A touching love story wrapped in an inventive tale of science fiction. This book has sold and sold.

Click to buy from Amazon.com or Amazon.co.uk

7. The Kite Runner.
By Khaled Hosseini. *Riverhead; 400 pages; $8.40. Bloomsbury; £3.99*

An Afghan version of the American immigrant experience turns into a story of redemption when the narrator returns to his homeland to rescue the son of his childhood friend who has been shot by the Taliban.

Click to buy from Amazon.com or Amazon.co.uk

8. Micah.
By Laurell K. Hamilton. *Jove; 288 pages; $7.99*

Federal marshal and vampire-hunter Anita Blake is at the centre of a tale that offers equal portions of hot sex and supernatural crime fighting, served up in a world where the new were-animals have their own crisis hotline. The next volume comes out in June.

Click to buy from Amazon.com or Amazon.co.uk

9. The Da Vinci Code.
By Dan Brown. *Doubleday; 454 pages; $14.97. Corgi Adult; £3.99*

The Vatican rag that offered a new take on corsetry is being kept in the limelight by a riveting plagiarism trial that may scupper Tom Hanks's new film (see article).

Click to buy from Amazon.com or Amazon.co.uk

10. Zwischen Himmel und Liebe (Where Rainbows End).
By Cecelia Ahern. Kruger; 500 pages; €16.90

A bittersweet tale of childhood friends who are separated as teenagers, by a rising young Irish light-romantic talent who is gaining in international popularity.

Click to buy from Amazon.de

Global sales from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.de, Amazon.fr, Amazon.jp February 1st-27th 2006. Prices are correct as of February 28th 2006.

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Rembrandt at 400

The eyes have it

Mar 2nd 2006 | AMSTERDAM
From The Economist print edition

As artists, Rembrandt and Caravaggio were truly kindred spirits

REMBRANDT and Caravaggio have long been spoken of in the same breath. One 18th-century writer called Caravaggio "the Rembrandt of Italy", while another described the Dutch painter as "the Caravaggio from beyond the Alps". Lord Clark, a former director of London's National Gallery, remarked on the striking connection, identifying their dramatic use of light and dark and their rebellion against classical ideals of beauty. Clark spent a lifetime looking at pictures, often in his own halls. The National Gallery owns both Rembrandt's "Belshazzar's Feast" and Caravaggio's "Supper at Emmaus", two of the paintings that most reveal the affinity between these barons of the Baroque.

Devoted dad

Until now, these works have never been displayed side by side. But for Duncan Bull, the senior curator of paintings at the Rijksmuseum, they formed the starting point for organising "Rembrandt-Caravaggio", an exhibition to mark Rembrandt's 400th birthday this year. "We wanted to celebrate Rembrandt alongside an artist who thought alike and who took up similar visual ideas," he explains.

Rembrandt's scene is grand and Caravaggio's humble, but both artists use light to focus on a moment of recognition in the faces and gestures of the subjects; everything else is cast in shadow. This show is not about artistic influence," says Mr Bull. "It is about how artistic brains work."

The result is a feast, though more a tasting of exquisite flavours than a balanced meal. The last thing Mr Bull wanted was to offer a survey or an art history lesson. With just 38 pictures, "Rembrandt-Caravaggio" feeds viewers exquisite morsels and invites them to linger and look.

The first pairing of paintings, showing Abraham sacrificing his son, sets the stage dramatically. Rembrandt captures Abraham's fatherly anguish, how he tries to shield Isaac from pain by completely covering his face, and his relief as the angel knocks the knife from his hand (pictured above). By contrast, Caravaggio's rendition of this scene revels in its cruelty: you can practically hear Isaac scream as he writhes in terror at the sharp blade pointed towards him (pictured below).

Rembrandt was four when Caravaggio died. He never left Holland, so he never saw an original painting by him. But he learned about Caravaggio from his teacher Peter Lastman, who had seen Caravaggio's work in Rome and was one of many Dutch artists who emulated the Italian master's trademark contrasts of light and dark. While Lastman and other Dutch Caravaggisti imitated Caravaggio's style, they were never able to capture his emotional substance, as their derivative work on display here shows.

...and demon

Rembrandt, on the other hand, took Caravaggio's brush and ran with it, seeking always to address the question of how to recreate nature in paint. For him this meant capturing the inner life of his subjects—moments of awareness, decision and reflection that flicker across faces and make them human. This is especially true of his paintings of women, which exude a "will she or won't she" quality that keeps the viewer guessing. Rembrandt's "Bathsheba Bathing" stops the viewer, not because of the voluptuousness of her naked body, but because your eyes focus on her face rather than her flesh. As she reflects upon King David's letter inviting her to betray her husband, you look at her eyes, her hand clutching the letter and her feet being washed by an old crone, whose ugliness points to the transitory nature of physical beauty. You know that she will be unfaithful, but Rembrandt shows Bathsheba in her moment of decision and invites the viewer to consider her options.

Caravaggio's women, on the other hand, seem typecast: they are either martyrs (Saint Ursula) or calculating females (Judith calmly slicing off the head of Holofernes); madonnas or, more commonly, whores (Mary Magdalene). He shows them in moments of concentration, pain and heroism, but never in moments of tenderness, as becomes apparent when you look at his "Conversion of the Magdalene" alongside Rembrandt's enigmatic "Jewish Bride", the ultimate image of domestic love. Both pictures conjure up the subtleties of human relationships. But, as Van Gogh wrote when admiring this painting, "Rembrandt says things for which there are no words in any language."

Artistic comparisons inevitably turn into contests, yet it seems invidious to declare a winner here, especially when the real winner is the viewer, who gets more than the sum of the exhibition's parts. While some combinations of paintings fail to convince, both artists resonate with modern eyes. Nonetheless, in his unflinching portrayals of psychological depth, it is Rembrandt who most often offers viewers a cast of their own humanity.

"Rembrandt-Caravaggio" is at the Van Gogh Museum, Amsterdam, until June 18th. Tickets, by prior booking only, are available at www.rembrandt-caravaggio.com

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Otis Chandler

Mar 2nd 2006
From The Economist print edition

Otis Chandler, newspaper publisher, died on February 27th, aged 78

Getty Images

OWNING a newspaper is different from owning other sorts of business. The returns are often psychic. The owners of banks, department stores or sausage factories want profits above all and tend to be ruthless about tearing apart, or even selling, their businesses when the dividends dry up. But newspaper proprietors have interests beyond the accounts. In a small country like England, which has a national press, they tend to seek political influence, and ideally a peerage too. In America, where papers have traditionally served little more than a single city, the dividend comes from stirring civic pride, satisfying the mission to inform and helping to build the finest community you ever did see.

That is the way it begins, anyway. After a generation or two, however, the patriarch's ideals may burn less brightly, or perhaps his descendants would rather take their share of the capital and spend it on some enthusiasm of their own. All across America, considerations such as these have prompted families to sell their papers, and it would surely have come as no great surprise had the Chandlers been among them, when Otis, as the representative of the fourth generation of the family that had published the *Los Angeles Times* since 1882, was suddenly put in charge in 1960. Instead, he created one of the best newspapers in the United States.

One reason why Otis might have sold was that he was less well known for any addiction to the inky-fingered arts of journalism than for putting the shot, riding motorbikes and hanging ten on a longboard in Malibu when the surf was up. The other was that Los Angeles might have seemed to offer few of the psychic rewards to a newspaper owner that Minneapolis, say, or Milwaukee, might provide.

The Los Angeles in which he had grown up was a dull place, mostly peopled by bland, heat-seeking migrants from the mid-west. The war had brought lots of younger arrivals, scientists and aerospace technicians, and Jewish refugees who helped develop the arts—a particular interest of Mr Chandler's mother, Dorothy. This made Los Angeles more interesting, but it was still just a dwelling-place, a collection of suburbs that were necessarily spread out because until 1906 they had been dependent on artesian wells for their water. It was not a coherent city with a centre, a citizenry, a group of identifiable civic bigwigs of the type to be found in Des Moines or San Francisco and a society worthy of the name.

Instead, Los Angeles had cliques. If you went out to dinner, you could be fairly sure you would find yourself in the company of other members of your own profession, whether that was oil or property or the law. And they would be Republicans—unless you were from the Westside, in which case they would perhaps be Jewish and Democratic and connected with "the industry", which is to say showbiz.

Otis the elevator

The newspaper that Mr Chandler took over in 1960 reflected the old Los Angeles: it was dull, predictable and primitively right-wing. Yet to widespread surprise, including his family's, Mr Chandler soon set about turning the

Times into a serious, intelligent and broadly fair-minded paper better suited to the increasingly varied people now pouring into southern California, not all of whom were as vacuous and unlettered as their reputation supposed. Money was invested, offices opened at home and abroad, award-winning journalists hired and sections added until the former light-weight rag had grown so hefty that doorsteps trembled at its descent. The *Times* ran critical articles about the right-wing John Birch Society, and sympathetic ones about blacks and Mexicans. Pulitzer prizes tumbled forth, and circulation, advertising and profits soared.

But Mr Chandler's zeal did not, and in 1980, at the age of only 52, he gave up his job as publisher. The law of diminishing dynastic interest seemed to be kicking in. He remained on the board (in the chair for five years), and signs of loyalty to principles appeared in 1999 when he wrote an open letter to the paper's employees condemning a secret deal in which the management had agreed to devote an edition of the Sunday magazine to a local sports arena in return for sharing the advertising profits. But neither the *Times* nor the group's other concerns—television stations and book publishers, as well as newspapers such as *Newsday*, the *Baltimore Sun* and the *Hartford Courant*, all of them bought during his tenure—seemed to inspire him. He preferred old cars, especially if they were fast, big-game hunting and the great outdoors.

Four months after his letter to the staff, Times Mirror, the parent company, was sold. A year before, he had said that "Nothing but my kids is more important to me than the *Los Angeles Times*," and perhaps he saw the sale, for $8.2 billion, to the Tribune company of Chicago, as a way of safeguarding his legacy, as well as a rebuke to the managers who now ran the paper. Or perhaps he simply had no influence over his family. In any event, the Chandlers had come to see their inheritance much as sausage-makers see their factories, so it went. With the *Times*'s circulation and profitability now diminished, and little love for the new owners, the age of Otis seems greater than ever.

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Overview

Mar 2nd 2006
From The Economist print edition

The **euro area's** businessmen remain in buoyant mood. The European Commission's business-climate indicator reached its highest level in five years in February. In Germany the Ifo index also rose, giving its brightest reading since October 1991. The country's unemployment rate remained unchanged in February at 11.3%, or almost 4.7m people.

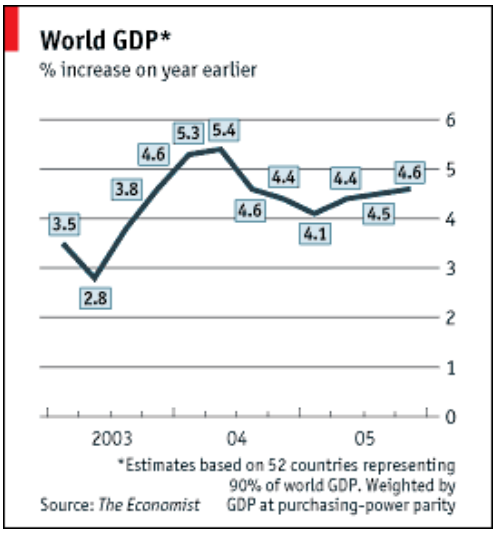
Annual **inflation** in the euro area quickened to 2.4% in January, though core inflation (excluding energy, food and tobacco) eased to 1.2%, mainly thanks to a drop in the price of clothes. Headline inflation in February is expected to be 2.3%, according to provisional estimates.

America's economy grew at an annual rate of 1.6% in the last quarter of 2005, not 1.1% as originally estimated. But though the past was better than first thought, consumers are less confident about the future, according to the Conference Board's index of consumer sentiment. Despite their doubts, consumers are still spending freely. America's **personal saving rate** fell to –0.7% of disposable income in January, as consumers' outlays exceeded their income by $63.3 billion.

In **Japan** industrial production expanded by 0.3% in January, leaving it 2.1% higher than a year before.

Canada's economy slowed at the end of last year, growing at an annual pace of 2.5% in the fourth quarter, after posting growth of 3.5% in the third.

The global economy quickened in the last quarter of 2005, according to *The Economist*'s world GDP indicator. Growth was 4.6% in the year to the fourth quarter, compared with 4.5% in the year to the third quarter.



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Output, demand and jobs

Mar 2nd 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.7	Q4	+ 1.9	+ 2.5	+ 3.1	+ 1.3	Q3	+ 1.9	Q4	5.3	Jan	5.1
Austria	+ 2.1	Q4	+ 2.8	+ 1.9	+ 2.1	+ 2.8	Nov	+ 1.5	Nov	5.1	Jan	5.0
Belgium	+ 1.5	Q4	+ 2.4	+ 1.4	+ 2.0	+ 2.2	Dec	+ 2.0	Dec	12.9	Dec†	12.8
Britain	+ 1.8	Q4	+ 2.4	+ 1.7	+ 2.1	– 2.7	Dec	+ 1.3	Jan	5.1	Dec††	4.7
Canada	+ 2.9	Q4	+ 2.5	+ 2.9	+ 3.2	+ 2.0	Dec	+ 3.9	Nov	6.6	Jan	7.0
Denmark	+ 4.8	Q3	+ 5.7	+ 3.3	+ 2.8	+ 5.5	Dec	+ 5.0	Jan	5.1	Dec	6.1
France	+ 1.2	Q4	+ 0.9	+ 1.6	+ 2.0	– 0.4	Dec	+ 2.1	Dec	9.6	Jan	10.1
Germany	+ 1.0	Q4	nil	+ 1.1	+ 1.7	+ 3.4	Dec	+ 1.7	Jan	11.3	Feb§	11.9
Italy	+ 0.1	Q3	+ 1.1	+ 0.1	+ 1.2	+ 3.5	Dec	+ 0.4	Nov	7.5	Sep	7.9
Japan	+ 4.2	Q4	+ 5.5	+ 2.6	+ 2.5	+ 2.1	Jan	+ 1.2	Dec	4.4	Dec	4.5
Netherlands	+ 1.6	Q4	+ 3.9	+ 0.9	+ 1.9	+ 1.4	Dec	+ 4.0	Nov	6.2	Jan**	6.6
Spain	+ 3.5	Q4	+ 3.9	+ 3.4	+ 3.0	+ 0.9	Dec	nil	Dec	8.4	Jan	10.1
Sweden	+ 3.4	Q3	+ 3.9	+ 2.6	+ 3.2	+ 2.7	Dec	+ 7.7	Jan	6.3	Jan†	5.5
Switzerland	+ 2.7	Q4	+ 2.1	+ 1.8	+ 2.2	+ 2.8	Q3	+ 3.1	Dec	3.9	Jan†	4.1
United States	+ 3.2	Q4	+ 1.6	+ 3.6	+ 3.3	+ 3.1	Jan	+ 4.4	Dec	4.7	Jan	5.2
Euro area	+ 1.7	Q4	+ 1.2	+ 1.4	+ 1.9	+ 2.5	Dec	+ 0.8	Dec	8.3	Jan	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.9	Q4	+ 3.7	na	na	+ 1.1	Jan	+ 6.5	Dec	8.2	Jan	8.9
Greece	+ 3.7	Q4	na	na	na	– 0.9	Dec	+ 1.6	Nov	9.7	Q3	10.1
Iceland	+ 4.0	Q3	na	na	na	na		na		1.5	Dec†	2.7
Ireland	+ 4.8	Q3	+ 1.3	na	na	+ 4.3	Dec	+ 5.0	Dec	4.3	Jan	4.2
Luxembourg	+ 3.1	Q1	na	na	na	+ 5.9	Nov	+ 0.2	Dec	5.0	Dec	4.5
New Zealand	+ 2.0	Q3	+ 0.2	na	na	– 2.7	Q3	+ 3.0	Q4	3.6	Q4	3.6
Norway	+ 3.1	Q3	+ 3.2	na	na	+ 2.6	Dec	+ 6.6	Jan	4.5	Dec**	4.4
Portugal	+ 0.2	Q3	– 3.7	na	na	+ 5.1	Dec	+ 1.5	Dec	8.0	Q4†	7.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Oct-Dec; claimant count rate 2.9% in Jan.
§EU harmonised rate 9.1% in Jan. **Nov-Jan. **Oct-Dec.

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Prices and wages

Mar 2nd 2006
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2005	2006	latest		year ago	latest		year ago
Australia	+ 2.8	Q4	+ 2.6	+ 2.7	+ 2.9	+ 4.8	Q4	+ 8.2	+ 6.1	Q3	+ 3.5
Austria	+ 1.2	Jan	+ 2.9	+ 2.3	+ 1.9	+ 1.7	Jan	+ 4.7	+ 2.7	Jan	+ 2.1
Belgium	+ 2.4	Feb	+ 2.6	+ 2.7	+ 2.2	+ 3.5	Jan	+ 5.1	+ 2.3	Oct	+ 2.4
Britain	+ 1.9	Jan*	+ 1.6	+ 2.1	+ 2.0	+ 2.9	Jan	+ 2.6	+ 3.6	Dec†	+ 4.3
Canada	+ 2.8	Jan	+ 2.0	+ 2.3	+ 2.2	+ 2.2	Jan	+ 3.7	+ 1.5	Nov	+ 2.6
Denmark	+ 2.1	Jan	+ 1.0	+ 1.8	+ 1.9	+ 4.6	Jan	+ 3.0	+ 2.9	Q4	+ 2.9
France	+ 2.0	Jan	+ 1.6	+ 1.8	+ 1.7	+ 3.7	Jan	+ 2.9	+ 3.3	Q4	+ 3.0
Germany	+ 2.1	Feb	+ 1.8	+ 2.0	+ 1.7	+ 2.9	Jan	+ 3.4	+ 0.8	Dec	+ 1.4
Italy	+ 2.2	Jan	+ 1.9	+ 2.1	+ 2.1	+ 4.7	Jan	+ 4.5	+ 2.3	Dec	+ 3.3
Japan	– 0.1	Dec	+ 0.2	– 0.2	+ 0.3	+ 2.7	Jan	+ 1.4	+ 1.6	Dec	+ 0.8
Netherlands	+ 1.3	Jan	+ 1.5	+ 1.5	+ 1.6	+ 6.3	Jan	+ 4.7	+ 1.4	Jan	+ 0.7
Spain	+ 4.2	Jan	+ 3.1	+ 3.4	+ 3.2	+ 6.3	Jan	+ 4.8	+ 1.9	Q3	+ 2.2
Sweden	+ 0.6	Jan	nil	+ 0.6	+ 1.5	+ 6.0	Jan	+ 2.5	+ 3.3	Nov	+ 2.4
Switzerland	+ 1.3	Jan	+ 1.1	+ 1.2	+ 1.1	+ 1.7	Jan	+ 1.3	+ 0.9	2004	+ 1.4
United States	+ 4.0	Jan	+ 3.0	+ 3.4	+ 2.9	+ 5.7	Jan	+ 3.9	+ 3.3	Jan	+ 2.6
Euro area	+ 2.3	Feb	+ 2.1	+ 2.2	+ 2.0	+ 4.6	Dec	+ 3.5	+ 2.2	Q3	+ 1.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.8	Jan	+ 0.2	na	na	+ 5.5	Jan	+ 1.2	+ 3.5	Q4	+ 4.3
Greece	+ 3.2	Jan	+ 4.0	na	na	+ 9.3	Jan	+ 3.3	na		na
Iceland	+ 4.1	Feb	+ 4.5	na	na	+ 3.8	Jan	+ 8.6	+ 8.3	Jan	+ 6.6
Ireland	+ 3.0	Jan	+ 2.3	na	na	+ 2.7	Jan	– 0.4	+ 3.5	Q3	+ 4.7
Luxembourg	+ 2.9	Jan	+ 2.0	na	na	+ 3.5	Dec	+17.0	+ 0.8	Nov	+ 3.9
New Zealand	+ 3.2	Q4	+ 2.7	na	na	+ 6.5	Q4	+ 3.4	+ 3.1	Q4	+ 2.5
Norway	+ 1.8	Jan	+ 1.1	na	na	+25.4	Jan	+11.7	+ 2.6	Q3	+ 4.3
Portugal	+ 2.6	Jan	+ 2.0	na	na	+ 5.3	Jan	+ 4.2	– 0.4	Dec	– 1.8

*RPI inflation rate 2.4% in Jan. †Oct-Dec.

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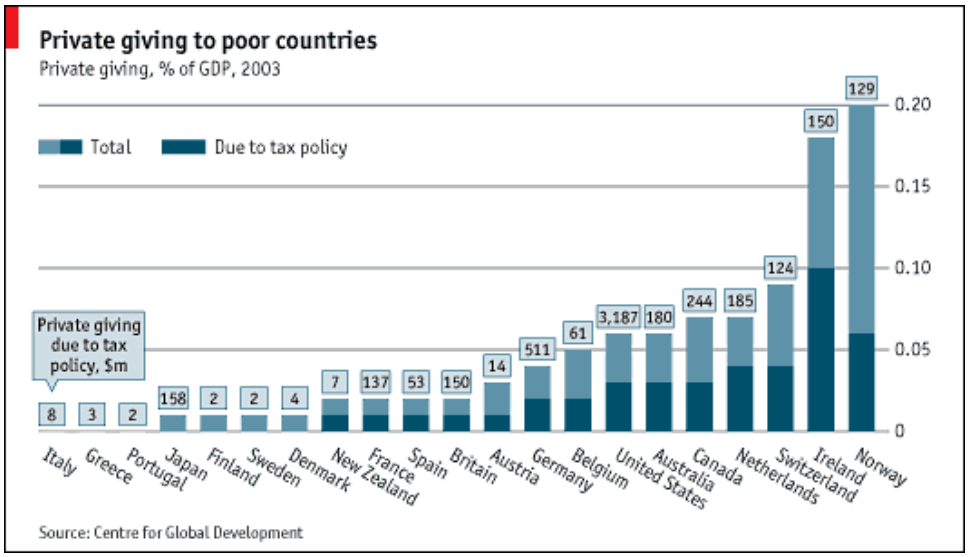
Private giving to poor countries

Mar 2nd 2006
From The Economist print edition

About $11.1 billion a year is funnelled to poor countries through private charities, according to the OECD, which tracks aid from 22 donor countries. This private giving is stimulated partly by public policies, notes David Roodman of the Centre for Global Development. Some governments provide tax breaks for charitable giving. In others, low taxes "crowd-in" private generosity, by leaving more money in the pockets of citizens.



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Money and interest rates

Mar 2nd 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Mar 1st 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 6.4	+ 8.1	Jan	5.61	5.76	5.18	5.25	5.57	6.27
Britain	+ 6.6	+11.7	Jan	4.53	4.91	4.32	4.15	4.83	5.13
Canada	+ 9.1	+ 6.9	Jan	3.74	2.42	3.96	4.17	4.37	5.27
Denmark	+29.2	+24.0	Jan	2.76	2.25	3.19	3.50	3.82	5.01
Japan	+ 5.3	+ 1.9	Jan	0.03	0.02	0.48	1.63	1.50	1.79
Sweden	+ 1.7	+10.1	Jan	1.94	1.96	2.69	3.39	3.89	3.32
Switzerland	+ 1.5	+ 3.3	Jan	1.18	0.76	1.84	2.25	2.21	2.31
United States	+ 1.1	+ 8.1	Jan	4.55	2.82	4.69	4.58	4.38	5.41
Euro area†	+10.2	+ 7.6	Jan	2.67	2.14	3.00	3.48	3.74	4.04

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.61%, Japan No. 276 1.56%. Central bank rates: US fed funds 4.50%, ECB refinancing 2.25%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, J.P. Morgan Chase, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Mar 2nd 2006
From The Economist print edition

2000=100

	Feb 21st	Feb 28th*	% change on one month	% change on one year
Dollar index				
All items	155.4	153.3	– 2.2	+13.6
Food	138.0	134.1	– 2.3	+ 4.7
Industrials				
All	178.0	178.0	– 2.2	+24.0
Nfa†	149.2	149.9	+ 0.7	+14.4
Metals	193.7	193.3	– 3.4	+28.5
Sterling index				
All items	135.2	132.7	– 0.8	+24.6
Euro index				
All items	120.8	118.9	– 0.4	+25.7
Yen index				
All items	171.6	164.7	– 3.3	+26.0
Gold				
$ per oz	554.75	559.75	– 1.8	+29.5
West Texas Intermediate				
$ per barrel	60.83	61.64	– 9.0	+19.4

* Provisional. † Non-food agriculturals.

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Stockmarkets

Mar 2nd 2006
From The Economist print edition

Market indices

	Mar 1st	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	4,813.8	4,903.9	4,708.8	– 0.6	– 1.8	+ 2.2	+ 3.7
Austria (ATX)	4,050.0	4,158.6	3,682.4	– 2.0	– 2.6	+10.4	+11.7
Belgium (Bel 20)	3,882.9	3,929.1	3,573.9	– 0.4	– 1.2	+ 9.4	+10.7
Britain (FTSE 100)	5,844.1	5,875.9	5,618.8	– 0.5	–15.7	+ 4.0	+ 6.2
Canada (Toronto Composite)	11,794.6	12,080.5	11,272.3	nil	– 2.4	+ 4.6	+ 7.5
Denmark (OMXCB)	381.8	383.4	362.0	+ 0.6	– 0.4	+ 3.8	+ 5.0
France (SBF 250)	3,558.9	3,570.5	3,327.6	+ 0.5	–18.9	+ 7.8	+ 9.1
(CAC 40)	5,057.6	5,080.5	4,748.3	+ 0.3	–26.9	+ 7.3	+ 8.5
Germany (DAX)*	5,866.6	5,915.2	5,334.3	+ 0.1	–27.3	+ 8.5	+ 9.7
Italy (S&P/MIB)	37,809.0	38,322.0	35,652.0	– 0.7	–24.5	+ 5.9	+ 7.1
Japan (Nikkei 225)	15,964.5	16,747.8	15,341.2	+ 1.2	–59.0	– 0.9	+ 0.8
(Topix)	1,635.6	1,713.5	1,572.1	+ 1.6	–43.3	– 0.9	+ 0.9
Netherlands (AEX)	461.7	467.5	431.5	– 0.9	–34.2	+ 5.7	+ 6.9
Spain (Madrid SE)	1,288.0	1,288.0	1,156.8	+ 1.2	nil	+11.4	+12.7
Sweden (Affarsvarlden Gen)	311.4	314.0	287.3	+ 0.5	–22.2	+ 6.1	+ 6.7
Switzerland (Swiss Market)	7,980.4	8,040.5	7,583.9	– 0.7	– 5.1	+ 5.2	+ 5.8
United States (DJIA)	11,053.5	11,137.2	10,667.4	– 0.8	– 5.7	+ 3.1	+ 3.1
(S&P 500)	1,291.2	1,294.2	1,248.3	– 0.1	–15.5	+ 3.4	+ 3.4
(NASDAQ Comp)	2,314.6	2,331.4	2,205.3	+ 1.4	–54.2	+ 5.0	+ 5.0
Europe (FTSEurofirst 300)†	1,356.0	1,363.8	1,277.1	– 0.2	–20.5	+ 6.3	+ 7.5
Euro area (FTSE Euro 100)†	1,164.1	1,173.7	1,078.9	– 0.2	–24.9	+ 6.9	+ 8.1
World (MSCI)‡	1,316.3	1,319.1	1,259.1	+ 0.6	– 9.1	+ 4.7	+ 4.7
World bond market (Citigroup)††	624.4	638.9	619.8	+ 0.5	– 5.7	+ 0.7	+ 0.7

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Mar 2nd 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Mar 1st	year ago	Currency units per $ Mar 1st	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 13.6	Dec	− 42.1	Q4	− 5.9	− 5.3	117.9	115.8	1.34	1.28	2.36	1.60	1.16	+ 1.0
Austria	− 1.9	Dec	+ 0.5	Dec	nil	+ 0.1	104.7§	106.2	0.84	0.76	1.47	–	0.72	− 2.0
Belgium	+ 10.9	Dec	+ 8.2	Sep	+ 1.8	+ 2.0	106.2§	108.3	0.84	0.76	1.48	–	0.73	nil
Britain	−119.1	Dec	− 40.6	Q3	− 2.0	− 2.3	98.5	100.8	0.57	0.52	–	0.69	0.50	− 3.1
Canada	+ 55.6	Dec	+ 25.2	Q4	+ 1.9	+ 1.8	127.8	115.1	1.14	1.24	2.00	1.36	0.98	+ 1.3
Denmark	+ 9.6	Dec	+ 8.7	Dec	+ 3.2	+ 3.0	105.9	106.5	6.25	5.68	11.0	7.46	5.39	+ 2.8
France	− 32.0	Dec	− 41.6	Dec	− 1.3	− 1.2	106.9§	109.2	0.84	0.76	1.48	–	0.73	− 3.2
Germany	+200.0	Dec	+112.8	Dec	+ 4.0	+ 3.8	108.3§	110.9	0.84	0.76	1.48	–	0.73	− 3.9
Italy	− 13.1	Dec	− 24.6	Dec	− 1.5	− 1.4	106.5§	108.8	0.84	0.76	1.48	–	0.73	− 4.3
Japan	+ 94.0	Dec	+164.0	Dec	+ 3.5	+ 3.6	83.1	88.5	116	105	203	138	–	− 6.5
Netherlands	+ 40.1	Dec	+ 39.8	Q4	+ 5.0	+ 5.0	107.0§	109.1	0.84	0.76	1.48	–	0.73	− 1.6
Spain	− 96.4	Nov	− 84.0	Nov	− 6.7	− 6.9	104.9§	106.4	0.84	0.76	1.48	–	0.73	+ 0.3
Sweden	+ 19.6	Jan	+ 21.8	Q4	+ 7.0	+ 6.8	94.9	100.1	7.92	6.92	13.9	9.45	6.83	+ 1.2
Switzerland	+ 6.6	Jan	+ 49.3	Q3	+13.5	+13.4	105.5	108.0	1.31	1.18	2.30	1.57	1.13	− 1.6
United States	−782.1	Dec	−780.6	Q3	− 6.5	− 6.6	86.3	81.9	–	–	1.75	1.19	0.86	− 3.7
Euro area	+ 29.1	Dec	− 35.4	Dec	− 0.1	− 0.1	115.5	118.6	0.84	0.76	1.48	–	0.73	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 10.6	Dec	+ 5.6	Dec	na	na	107.8§	109.8	0.84	0.76	1.48	–	0.73	+ 2.1
Greece	− 34.1	Nov	− 17.5	Dec	na	na	104.0§	105.3	0.84	0.76	1.48	–	0.73	− 4.5
Iceland	− 1.6	Jan	− 2.2	Q3	na	na	109.0**	92.7	65.1	60.8	114	77.6	56.1	+ 2.0
Ireland	+ 40.2	Dec	− 3.7	Q3	na	na	111.4§	115.4	0.84	0.76	1.48	–	0.73	− 0.9
Luxembourg	− 4.8	Dec	+ 3.5	Q3	na	na	106.2§	108.3	0.84	0.76	1.48	–	0.73	− 2.3
New Zealand	− 4.9	Jan	− 9.1	Q3	na	na	133.2	136.3	1.50	1.38	2.64	1.80	1.30	+ 5.3
Norway	+ 49.6	Jan	+ 43.7	Q3	na	na	109.1	106.7	6.71	6.27	11.8	8.01	5.79	+ 15.3
Portugal	− 23.3	Nov	− 16.7	Nov	na	na	104.7**	105.1	0.84	0.76	1.48	–	0.73	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average (corrected data). ‡OECD estimate. **IMF, October average (corrected data).

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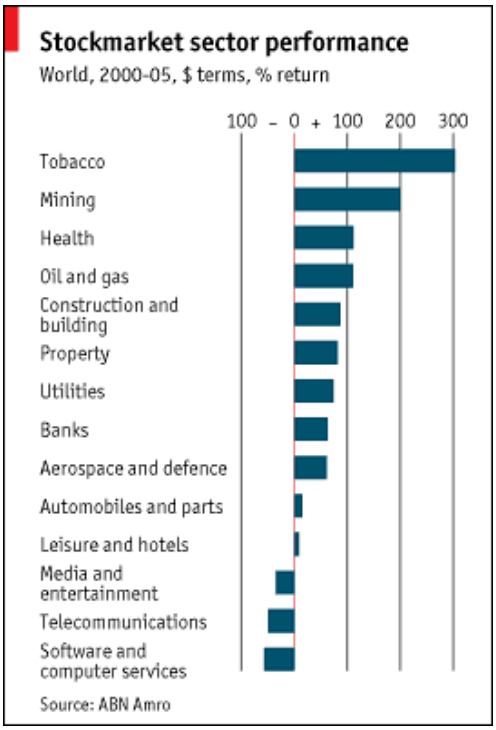
About sponsorship

Stockmarket sector performance

Mar 2nd 2006
From The Economist print edition



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Overview

Mar 2nd 2006
From The Economist print edition

Brazil's economy, the biggest in South America, grew by 2.3% last year, sharply down from 4.9% in 2004. But **South Africa's** economy, the largest in Africa, expanded by 4.9% in 2005, up a bit from 4.5% in 2004.

In the **Philippines**, industrial-production growth slowed to 0.1% in the 12 months to December 2005. In **Singapore** it slackened to 1.3% in the year to January.

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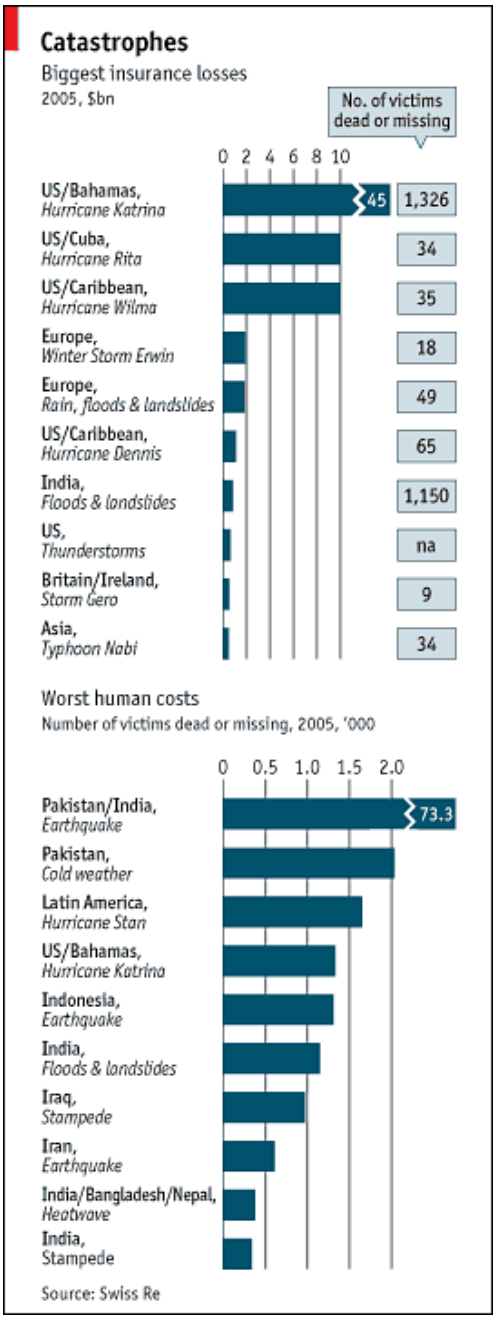
Catastrophes

Mar 2nd 2006
From The Economist print edition

More than 73,000 people died in last year's earthquake in Pakistan and India. Swiss Re, a reinsurance company, estimates that the total cost of the damage was $5 billion, but most of it was uninsured. Hurricane Katrina caused the greatest damage last year, at $135 billion. Claims on insurers amounted to $45 billion—the biggest insured loss in post-war history.



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Economy

Mar 2nd 2006
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+16.5	Dec	+ 1.9	Jan	+105.1	Jan	+128.5	H1	818.9	Dec
Hong Kong	+ 7.6	Q4	+ 4.1	Q3	+ 2.6	Jan	– 9.7	Jan	+21.0	Q3	127.8	Jan
India	+ 7.6	Q4	+ 5.0	Dec	+ 4.4	Jan	–37.4	Jan	–18.3	Q3	133.4	Jan
Indonesia	+ 4.9	Q4	+ 2.1	Dec	+17.9	Feb	+29.1	Jan	+ 0.7	Q3	33.1	Dec
Malaysia	+ 5.2	Q4	+ 4.2	Dec	+ 3.2	Jan	+26.4	Dec	+18.7	Q3	70.7	Jan
Pakistan	+ 8.4	2005†	+19.3	Sep	+ 8.8	Jan	– 9.4	Jan	– 3.7	Q3	9.8	Jan
Philippines	+ 6.1	Q4	+ 0.1	Dec	+ 6.7	Jan	– 3.7	Dec	+ 2.9	Sep	17.8	Jan
Singapore	+ 8.7	Q4	+ 1.3	Jan	+ 1.8	Jan	+31.1	Jan	+33.2	Q4	120.2	Jan
South Korea	+ 5.2	Q4	+ 6.4	Jan	+ 2.3	Feb	+19.3	Feb	+15.7	Jan	216.9	Jan
Taiwan	+ 6.4	Q4	+ 4.4	Jan	+ 2.7	Jan	+ 9.6	Jan	+16.4	Q4	257.3	Jan
Thailand	+ 5.3	Q3	+ 5.8	Jan	+ 5.6	Feb	– 7.5	Jan	– 2.3	Jan	51.7	Jan
Argentina	+ 9.2	Q3	+ 3.3	Jan	+12.1	Jan	+11.3	Dec	+ 4.4	Q3	27.2	Dec
Brazil	+ 1.4	Q4	+ 3.2	Dec	+ 5.7	Jan	+45.4	Jan	+13.0	Jan	56.3	Jan
Chile	+ 5.2	Q3	+ 6.0	Dec	+ 4.1	Jan	+ 9.2	Jan	– 0.2	Q3	15.9	Jan
Colombia	+ 5.8	Q3	+ 0.6	Nov	+ 4.2	Feb	+ 1.4	Dec	– 1.7	Q3	14.6	Jan
Mexico	+ 2.7	Q4	+ 2.7	Dec	+ 3.9	Jan	– 6.0	Jan	– 5.7	Q4	74.1	Dec
Peru	+ 7.4	Dec	+ 2.7	Dec	+ 2.7	Feb	+ 5.1	Dec	+ 1.0	Q4	13.1	Jan
Venezuela	+10.2	Q4	+13.5	Dec	+12.5	Feb	+31.5	Q4	+25.4	Q4	23.4	Nov
Egypt	+ 5.2	Q1	+ 4.0	2005†	+ 3.4	Jan	–11.3	Q3	+ 1.8	Q3	20.8	Jan
Israel	+ 4.8	Q4	+ 7.0	Dec	+ 2.7	Jan	– 8.4	Jan	+ 2.4	Q3	28.3	Jan
Saudi Arabia	+ 6.5	2005‡	na		+ 1.1	Nov	+84.6	2004	+51.9	2004	26.5	Dec
South Africa	+ 4.5	Q4	+ 6.2	Dec	+ 4.0	Jan	– 4.1	Jan	–10.3	Q3	19.9	Jan
Czech Republic	+ 4.9	Q3	+ 7.1	Dec	+ 2.9	Jan	+ 1.8	Dec	– 3.4	Q3	29.5	Jan
Hungary	+ 4.3	Q4	+12.9	Dec	+ 2.7	Jan	– 3.4	Dec	– 8.7	Q3	20.1	Jan
Poland	+ 3.7	Q3	+ 9.5	Jan	+ 0.7	Jan	– 2.9	Dec	– 4.8	Dec	41.3	Jan
Russia	+ 7.0	Q4	+ 4.4	Jan	+10.6	Jan	+120.1	Dec	+86.6	Q4	181.4	Jan
Turkey	+ 7.0	Q3	+ 8.6	Dec	+ 7.9	Jan	–43.9	Jan	–22.3	Dec	52.9	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+10.8	Q3	+14.3	Dec	+ 4.7	Jan	– 2.5	Nov	– 1.4	Dec	1.9	Dec
Latvia	+11.4	Q3	+ 7.9	Dec	+ 7.5	Jan	– 3.0	Dec	– 2.0	Dec	2.2	Dec
Lithuania	+ 8.2	Q4	na		+ 3.5	Jan	– 3.6	Dec	– 1.8	Dec	3.7	Dec
Slovakia	+ 7.5	Q4	+ 8.7	Dec	+ 4.1	Jan	– 2.4	Dec	– 2.9	Oct	14.9	Dec
Slovenia	+ 3.7	Q3	+ 5.5	Dec	+ 2.4	Jan	– 1.7	Dec	– 0.3	Dec	7.9	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Mar 2nd 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Mar 1st		Dec 30th 2005	
	Mar 1st	year ago	Mar 1st	% a year		one week	in local currency	in $ terms
China	8.04	8.28	14.1	2.20	1,370.5	+1.7	+ 12.2	+ 12.7
Hong Kong	7.76	7.80	13.6	4.29	15,818.1	+1.2	+ 6.3	+ 6.3
India	44.4	43.7	77.8	6.67	10,565.5	+3.3	+ 12.4	+ 14.0
Indonesia	9,183	9,285	16,095	13.78	1,239.3	+0.7	+ 6.6	+ 14.2
Malaysia	3.71	3.80	6.50	3.46	921.6	-0.3	+ 2.4	+ 4.4
Pakistan	59.9	59.4	105	9.03	11,474.0	+0.2	+ 20.1	+ 19.8
Philippines	51.4	54.8	90.0	7.38	2,135.3	+3.3	+ 1.9	+ 5.2
Singapore	1.62	1.63	2.84	3.38	2,482.7	+2.3	+ 5.8	+ 8.7
South Korea	971	1,008	1,702	4.26	1,371.6**‡	+2.3	- 0.6	+ 3.5
Taiwan	32.3	30.8	56.6	1.65	6,613.4	+1.3	+ 1.0	+ 2.8
Thailand	39.0	38.4	68.4	4.80	748.3	+2.7	+ 4.8	+ 10.2
Argentina	3.07	2.95	5.38	8.31	1,741.9	+0.8	+ 12.9	+ 11.3
Brazil	2.13	2.63	3.74	17.29	39,177.9	+2.4	+ 17.1	+ 28.1
Chile	518	588	908	4.56	9,706.7	+0.7	+ 5.4	+ 4.3
Colombia	2,248	2,329	3,941	5.98	11,182.8	+1.1	+ 17.5	+ 19.6
Mexico	10.5	11.1	18.3	7.42	19,058.7	+1.5	+ 7.1	+ 8.8
Peru	3.31	3.26	5.79	3.90	6,173.3	+1.6	+ 28.5	+ 33.4
Venezuela	2,599§	2,667§	4,555	11.70	29,125.0	+6.9	+ 42.8	+ 42.1
Egypt	5.73	5.81	10.05	8.05	62,179.5	+3.1	+ 12.3	+ 12.4
Israel	4.70	4.33	8.23	5.12	829.4	+2.3	+ 0.2	- 1.8
Saudi Arabia	3.75	3.75	6.57	5.30	19,251.6	-5.4	+ 15.2	+ 15.2
South Africa	6.18	5.91	10.8	7.20	19,085.4	-3.0	+ 5.5	+ 8.3
Czech Republic	23.7	22.6	41.6	2.04	1,558.2	-0.2	+ 5.8	+ 9.7
Hungary	212	185	372	6.13	23,437.4	+0.1	+ 12.8	+ 13.6
Poland	3.16	2.99	5.54	4.08	39,195.0	+0.2	+ 10.1	+ 13.5
Russia	28.0	27.7	49.1	12.00	1,450.8‡	- 1.0	+ 25.7	+ 28.9
Turkey	1.31	1.28	2.29	14.59	47,493.0	+2.7	+ 19.4	+ 23.4
EM (MSCI)*	1.00	1.00	1.75	na	787.2	+1.0	+ 11.4	+ 11.4
EMBI+†	1.00	1.00	1.75	na	382.8	+0.8	+ 3.8	+ 3.8

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **Feb 28th.

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